JAPANESE VOLUNTARY RESTRAINTS ON AUTO EXPORTS TO THE UNITED STATES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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JAPANESE VOLUNTARY RESTRAINTS ON AUTO EXPORTS TO THE UNITED STATES

THURSDAY, FEBRUARY 28, 1985

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, DC.

The subcommittee met, pursuant to notice, at 11:35 a.m., in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

[The press release announcing the hearings follow:]

[For immediate release Friday, February 15, 1985]

THE HONORABLE SAM M. GIBBONS (D., FLA.), CHAIRMAN, SUBCOMMITTEE ON TRADE, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES HEARINGS ON JAPANESE VOLUNTARY RESTRAINTS ON AUTO EXPORTS TO THE UNITED STATES, FEBRUARY 28 AND MARCH 4, 1985

The Honorable Sam M. Gibbons (D., Fla.), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, today announced hearings to examine the issue of voluntary restraints on automobile exports to the United States, which are scheduled to expire on March 31, 1985. These restraints, which have been in place since April 1, 1981, were imposed in response to a desire to give U.S. auto manufacturers a temporary "breathing space," allowing them to make the transition to new competitive conditions characterized by high energy prices and sharply increased demand for small, fuel-efficient cars. Some recent studies have raised questions about the impact of these restraints on the U.S. economy and on the long-term competitiveness of the U.S. auto industry. At the same time, the large bilateral trade deficit with Japan and questions about the impact on U.S. auto companies of removing the voluntary restraints are concerns which deserve attention.

The purpose of the hearings will be to establish a full record of views on whether the voluntary restraints should be allowed to expire, be extended at current levels, or be modified in some way. Testimony will be received from both government and private sector witnesses, as well as from knowledgeable industry analysts. The hearings will be held on Thursday, February 28, 1985, beginning at 11:30 a.m., in the main Committee hearing room, 1100 Longworth House Office Building. The hearings will continue on Monday, March 4, 1985, at 1:30 p.m. in the same location. A list of witnesses will be announced prior to the hearings.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Requests to be heard must be made by telephone to Harriet Lawler [telephone (202) 225-3627] by close of business, Friday, February 22, 1985. The request should be followed by a formal written request addressed to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515.

In view of the limited time available to hear witnesses, the Subcommittee will not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance will be encouraged to submit written statements for the record of the hearings. All persons requesting to be heard, whether

they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesman to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearings. This process will afford more time for Members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available for questions, witnesses appearing before the Subcommittee are required to submit 200 copies of their prepared statements to the full Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance.

Requests to be heard must contain the following information:

1. The name, full address, and capacity in which the witness will appear, as well as a telephone number where he or his designated representative may be reached;
2. A list of any clients or persons, or any organization for whom the witness appears; and
3. A topical outline or summary of the comments and recommendation in the full statement.

The above information should also be incorporated in the prepared statements to be presented in person as well as those filed for the record of the hearings.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

Persons submitting a written statement in lieu of a personal appearance should submit at least six (6) copies of their statement, by the close of business Thursday, March 7, 1985, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearings wish to have their statements distributed to the press and the interested public, they may submit 100 additional copies for this purpose if provided to the Committee during the course of the public hearings.

Chairman GIBBONS. This is a meeting of the Trade Subcommittee of the Committee on Ways and Means, and we are here today to talk about, to consider, and to make definitive decisions on what may be the most important function of the U.S. Government—other than its national security function—and I think those two functions are interrelated.

Trade has grown to be the biggest function of our U.S. Government. It is, in dollar terms, even larger than our national security budget. It is now about $650 billion a year. No industry in the United States comes anywhere near that size in volume or impact upon our lives. I am a free trader; I am not a foolish trader. I am not a trader who wants to tolerate unfair trade practices. I believe that carrying on common commercial exchanges and transactions around the world will build a stronger world, a more peaceful world, and one in which all of us can live at a higher standard of living and with a great deal more personal security.

We are examining today a unique part of that picture. We are examining it because we want to find out whether it was worthwhile, what was its cost, and what was the net result of it. Whether the voluntary restraints on automobile exports that have been put in place by the Japanese Government are continued or not is wholly within the power and the responsibility of the Japanese Government.

The auto export restraints have impacted a large part of American commerce. They have impacted the American pocketbook. The

purpose of these hearings is to get the facts on the table and find out what the restraints cost and what good, if any, they did.

I am happy that in our first substantive, formal hearing this year, I am joined by my very distinguished colleague from Illinois, Representative Crane, who is the ranking Republican on this committee. I have worked with him before in this role on other subcommittees of the Ways and Means Committee, and before I go to you, Mr. Brock, I wonder, Mr. Crane, if you have anything you would like to say.

Mr. CRANE. Thank you, Mr. Chairman. I appreciate this opportunity to hear the testimony of our distinguished trade representative and also to have the opportunity to hear from some of the people in the auto industry. I confess that I was one of those who had very grave reservations about the introduction of so-called voluntary restraints.

On the other hand, I did have a sympathy for the plight of the U.S. auto industry in having had an opportunity to visit in Japan and to watch the degree of automation in their plants and the quality controls that they had imposed and the realization that we had not kept abreast of some of the technological improvements that greatly improve quality and productivity, notwithstanding the fact those inventions came from here, as the Japanese were very quick to remind us.

I was sympathetic, as I say, with the problems of the auto industry, but, on the other hand, distressed. If there was indeed a legitimate basis for trying to negotiate with the Japanese on this question at incredible cost to the American consumer in 1983 and 1984, I think that time has clearly passed based on the profit picture out of Detroit in 1983 and 1984.

I would hope that the Congress would proceed with some caution with respect to changing our Tax Code if in fact some of the things we did in the U.S. Tax Code in 1981 especially led to plant modernization and to plant expansion and ultimately increased productivity here at home. But the end result of any economic system, it seems to me, is to provide the consumer the best quality good at the lowest possible price.

And, therefore, free trade works in the best interest of the consumer so long as—and I underscore the word free—it is indeed free trade. And I think in this area, though, that one would be hard-pressed to argue that we did not have a climate of free trade prior to the voluntary restraints and that that action was taken for the protection of a domestic industry and one that, frankly, I would have been demoralized if it went under. But I think whatever relief they enjoyed, it is my personal feeling that that time has passed.

So, I look forward to hearing the testimony this morning and I look forward especially to our old friend and colleague Bill Brock.

Chairman GIBBONS. I am going to talk a little while longer before I start. As everyone in the audience knows, the U.S. Constitution 200 years ago set the powers of this committee. Article I of the Constitution, section 8, subsection 3, clearly gives us the power to control the external trade of the United States.

By experience and history, we have learned to delegate that responsibility to the President. We have established in the Office of the President the U.S. Trade Representative, who is a unique

person in the President's Cabinet. He is at a super-Cabinet level. His job is to coordinate the Cabinet functions and to give that coordinated advice to the President. He is a representative of the Congress in that office, and we welcome you here, Ambassador Brock.

You have done in my book an outstanding job. I have had an opportunity to work with many of your predecessors over the years and I want to commend you. You have filled the job with great distinction. Ambassador Brock.

STATEMENT OF HON. WILLIAM E. BROCK, U.S. TRADE REPRESENTATIVE

Ambassador BROCK. That was a very gracious introduction, Mr. Chairman, and I appreciate it. I think I should note just two things. If I tried to write down a creed for my conduct in office, I could not possibly put it better than your opening remarks. I appreciate the sentiments expressed, and the remarks of the gentleman from Illinois are equally appreciated.

I think, you know, when you have these conversations we use the words fair trade with some abandon, and there are many who criticize it and say we ought to be talking about fair trade. I would point out to you, Mr. Chairman, that true free trade is fair trade because free trade in its pure application means no form of government intervention, and that by definition is fair. The unfairness comes from an intervention of government to skew the process to benefit certain groups or certain countries against individuals in other places.

On the subject at hand today I will try to simply review these past 4 years. We are presently, as you know, examining the question of whether these restraints should be allowed to expire as scheduled on March 31 and what effects we might anticipate from that decision upon U.S. industry, its workers, and our consumers.

Recently the Cabinet has completed a review of the effects of the past restraints and also considered the issue of what should be communicated to the government of Japan with respect to the need for further restraints, if any. The outcome of those Cabinet deliberations or more precisely the general view of most of the President's advisors has been widely and fairly accurately reported by the press. However, I wish to emphasize that at this date no final cabinet recommendation has gone forward to the President nor has he made any final decision on the matter.

Nonetheless, I believe that a full airing on the general types of considerations raised before the Cabinet and elsewhere, both on the automotive issue on its own merits and in relationship to the broader question of our bilateral trade relationship with Japan, would be timely and helpful. And I welcome the opportunity this hearing affords to place these views on the record as well as to receive any thoughts that the members of this committee have on the subject.

In order to respond to some of the longstanding problems of the domestic automotive industry and their underlying causes, which I attempt to describe in some detail in my written testimony, this administration in 1981 took several actions. A regulatory relief pro-

gram was established which identified 34 auto industry related regulations which were inefficient in a cost-benefit sense. We tried in the tax bill to provide additional opportunities for investment and improvements in productivity. But I think at the core of the President's initiative was the recognition that revitalization of the total U.S. economy was the single most important factor in relieving the auto industry's problems.

We did welcome, as did many members of Congress, the original Japanese restraint action and its subsequent extensions. The Japanese Government stated that those were in recognition of the difficult adjustment situation in our industry and particularly in the small, fuel efficient car category. As the subcommittee well knows, the Japanese government undoubtedly restrained auto exports also in an effort to dull the increasing sentiment in the Congress for unilaterally imposed quotas or other trade restrictions.

What have been the results? Well, first, the industry responded by investing more than $40 billion in capital improvements through 1984.

Second, U.S. small car capacity increased from 1.4 million units in 1978 to 3.9 million units in 1983. Output of more fuel efficient, four cylinder engines with front-wheel drive transaxles were increased threefold. In addition, high technology electronics were incorporated to such an extent that the auto industry became the electronics industry's No. 1 customer.

Third, changes in many of the government's mandated regulations applicable to the industry have been completed resulting in savings to the industry and more precisely to the consumer. With the recovery of the general economy and with a cap on Japanese imports the U.S. automobile industry was well positioned to benefit from increases in auto demand over the last 2 years. Sales went up. Import market share underwent a corresponding decline. When combined with their own cost cutting efforts, which were substantial, this resulted in a record nominal profit for U.S. firms of $6.2 billion in 1983 and $9.8 billion in 1984. Even in constant dollars, last year's profit figures would translate to $6.2 billion well above the $4.9 billion level of 1978, the industry's last peak year.

Employment, which had dropped from over 1 million workers in 1978 to less than 700,000 in 1982 is again approaching 900,000 workers this January. Also many of the U.S. auto jobs lost were lost not to imports but rather to plant modernization, robotics, and the shift in production to relatively smaller, less labor intensive vehicles. The economy as a whole has generated over 8.5 million jobs during the last six quarters, a period of extraordinary economic growth, giving further relief to those displaced in this field as well as from the auto supplying industries.

Although the restraints contributed in some measure to the recovery of the domestic industry, they were not without their costs. In addition to the price and consumer cost estimates made in the recent USITC staff report, of which you are aware, other economists using alternative assumptions and methodologies have come up with somewhat lower consumer cost estimates in the neighborhood of $500 per car. But there is no serious question that trade restrictions are costly to consumers.

Another negative outcome was the economic rents accruing to the Japanese companies as a result of the temporary monopoly created by the restraints. The paradox is that the restraints were designed to aid the domestic industry, but in fact have increased the revenue of the Japanese producers, which can be plowed back into more innovation and productivity increases that in turn increase the long-term competitiveness of the Japanese auto industry. After awhile, Mr. Chairman, you start digging your own hole, in simple terms.

Proponents of auto trade restraints have generally advanced three major lines of argument for their continuation. One, the industry needed help and still does, which was the original justification for the restraints.

Second, the decision by some manufacturers on future investment plans, especially on the degree of domestic sourcing versus outsourcing on the new generation of small cars, the most competitive sector of the market, might be adversely affected by the expiration of restraints. In other words, we might increase outsourcing.

Third, with record U.S. trade deficits and the strong dollar, continuation of the restraints may be still needed to avoid further increases in the deficit, maintain domestic employment, and exert pressure for more openness in the Japanese market.

Now, if you look at those arguments individually, first, the general economy is now in a growth path that should continue for sometime if we are able to get the Government's financial house in order. What may be the most important trade action that Congress can take this year is to reduce the deficit. The auto industry has experienced increased sales and employment as a part of that recovery. Profits are at record levels in both nominal and real terms. The companies' financial statistics show considerable strengthening since the last recession. I think it is fair to say that the industry has gotten over a particularly difficult period and can reasonably be expected to stand on its own competitive abilities.

In sum, the original purposes of the restraint to any rational observer of the current state of the economy and the U.S. auto industry have been fulfilled.

Second, if the industry is now able to compete, should the Government intervene in the private decisionmaking process to encourage or to discourage specific investment programs, particularly in small cars. Such a course of action is certainly beyond the scope of the original intention of the restraints. More importantly it would be substituting the judgment of politicians for that of the marketplace.

It should surprise no one that most of us and I in this administration believe that the auto industry itself must decide what future product and investment plans to follow in an opening trading environment. To do otherwise could create demands for permanent protection to justify actions that might not otherwise be economically logical.

Coming to the third argument it has always been popular to support trade restricting actions by citing balance of payments or trade arguments. It is true that the soaring dollar does have adverse consequences for our exporting and import competing industries. In fact, all the gains the auto industry has made in cost sav-

ings over the last 4 years have probably been wiped out by the simultaneous decreasing value of the yen.

In a technical sense, the relatively high value of the dollar is largely responsible for our current trade difficulties. But it does not necessarily follow that we should take border actions as opposed to more sensible actions within our borders to correct the underlying macroeconomic conditions which have so appreciated the dollar. In sum, Mr. Chairman, we have to cleanup our own house and we cannot depend on others to do it for us. It is also true that the resistance of the Japanese market to imports has been an important factor in our trade deficit. In 1982 and 1984 the trade balance with Japan deteriorated by $18 billion.

U.S. exports to Japan increased only 2.6 billion while their exports to us increased by over 20 billion. It is absolutely critical that we reach an effective understanding soon with the Japanese on the serious problems of access to their market.

Many of us in the administration, in Congress, and certainly in the country are rapidly losing patience with the slowness of the market opening process in Japan, particularly when that nation enjoys such a significant trade surplus with us and with the rest of the nations of the world.

We are tired of hearing arguments that it is all a result of the highly valued dollar or our businessmen not trying hard enough. That is a felicitous but false argument. If the problem were only between the United States and Japan, you could blame a good deal on the dollar. But the fact is that Japan does not import finished goods from anybody, anywhere, anytime. And that is a very different issue. And the yen has gone up against other currencies and they should be then receiving more imports as we have been.

Over the last 12 years I and my predecessors in this office have concluded innumerable trade agreements with the Government of Japan. The net effect of these efforts has been to increase the flow of paper and diplomats between the two countries, but not goods. In addition to the obvious cost in lost trade these past efforts have often led to public rancor and disrupted the close and friendly relations which have been developed over the last 25 years.

I am convinced that most responsible Japanese leaders want to truly open their market, but that the political realities of their country have continually frustrated that objective to the detriment of our mutual trading and political relationship. To continue the auto restraints supposedly to increase our leverage in the current market opening discussions, as some have argued, would simply be playing into the hands of the protectionist elements in Japan. I believe they would like nothing better than to justify their continued, obstinate stance in not providing full access to their markets; from lumber to pharmaceuticals to telecommunications, where we have competitive advantage by citing their nation's own sacrifice in continuing the restraints. Restraints notwithstanding, Japanese automotive exports would in any case expand their sales to the U.S. market by billions of dollars because of the increased parts needed to support both the much expanded Japanese-origin auto fleet and the U.S. subsidiaries of Japanese firms operating automotive assembly facilities in this country.

The seduction of protected home markets should not be allowed to interfere with the commitment Japanese and United States leadership has made at the highest level toward free and fair trade between our two countries. Following the course of continued auto restrictions could cause us to lose on all counts: No improvement in Japanese market access, no improvement in the bilateral balance of trade, no improvement in the long-term competitive situation of the domestic automotive industry, additional costs and limitations in choice for the American consumer, and a backing away from freer trade, that has helped to curb our domestic inflation and supported current resurgence in the international economic system.

Mr. Chairman, we have learned from experience that U.S. industry stays competitive, efficient, profitable, and growing when it must make the tough decisions and necessary investments that come from a competitive environment. One past mistake is that we have allowed too many industries to get fat and lazy. We cannot let this happen again. Our future national well-being depends on our ability to meet the competition and not be isolated from it. Thank you.

[The prepared statement and attachments follow:]

STATEMENT OF AMBASSADOR WILLIAM E. BROCK, U.S. TRADE REPRESENTATIVE

Mr. Chairman, four years ago, the Government of Japan decided to restrict that country's automotive exports to the United States. They took that action in recognition of the difficult adjustment situation that the U.S. automotive industry was facing with respect to competing in the small, fuel-efficient car market and the enormous stresses this adjustment placed upon our manufacturers' financial resources and work force.

As this Subcommittee well knows, the Japanese Government undoubtedly restrained auto exports also in an effort to dull the increasing sentiment in the Congress for unilaterally imposed quotas or other trade restrictions. The Administration welcomed, as did many members of Congress, the original Japanese restraint action and its subsequent extensions as positive contributions to alleviating the adjustment problems that the domestic automotive industry was then having. However, it was also recognized that the fuel resolution of these problems lay in actions that the industry and labor, themselves, had to take to reduce costs, increase productivity and produce quality products.

Today, almost four years later, we again find ourselves examining the question of whether Japanese restraints should expire as scheduled on March 31, and the effects of that decision upon the U.S. industry and consumer. The Administration has continually monitored the restraints and consulted with the Japanese Government on the changing economic conditions in the domestic automotive industry. Recently, the Cabinet has completed a review of the effects of the past restraints and also considered the issue of what should be communicated to the Government of Japan with respect to the need for future restraints. The outcome of those Cabinet deliberations, or more precisely the general view of most of the President's advisors, has been widely and fairly accurately reported by the press. However, I wish to emphasize that at this date no final Cabinet recommendation has gone forward to the President, nor has the President made any decision on this matter.

Nonetheless, I believe that a full airing of the general types of considerations raised before the Cabinet and elsewhere, both on the automotive issue on its own merits and in relation to the broader issue of our bilateral trade relationship with Japan, would be timely and helpful; and I welcome the opportunity this hearing affords to place those views on the record, as well as to receive any thoughts the members of the Subcommittee wish to express on this matter.

Before giving my view on the current situation, I would like to take a few moments to review the condition of the automotive industry, as this Administration found it shortly after coming into office in 1981, and to describe, if I can, the underlying causes of the industry's problems.

In 1981, the "big four" auto companies had a combined net loss of $1.3 billion and were $13 billion in debt. Unemployment rates in this industry, in 1981, were twice

those for the nation as a whole. Sales of domestic cars were 6.2 million units, down by one-third from the peak level of 1978. Although in absolute terms auto import sales at the end of 1981 were only 250 thousand units higher than their level four years earlier, the fall off in domestic car sales caused the import market share to rise to 27 percent and the Japanese share to 22 percent.

With the benefit of hindsight, we can see that the problems of the U.S. industry have been coming for some time. Those problems came to full bloom in 1979, following the oil supply disruptions. The sudden rise in fuel prices and sporadic fuel shortages of that period resulted in a sharp shift in demand from larger cars to smaller, more fuel-efficient vehicles. Unsold imported cars and the relatively few U.S.-built subcompact cars, sitting in inventory previously, were suddenly in huge demand. U.S. manufacturers were not prepared to respond to such a rapid swing in demand.

To make matters worse, the real cost of buying and operating a car had been shooting upward during the previous long inflationary cycle, resulting in consumers holding on to their older cars and generally decreased sales. (In 1973, the average age of an auto in use was 5.7 years; however by 1983, this figure had risen to 7.4 years.) High management and labor costs were in place, while quality was not. In addition to this situation, the entire economy had been slipping into the sharpest recession since World War II resulting in severe declines in the postponable purchases of durable goods—and particularly automobiles.

The government's role in this situation could not at that time be called positive. Record high interest rates and taxes combined with record high car prices to suppress car demand. The government had also been sending conflicting signals to the marketplace by mandating the production of fuel-efficient cars, while simultaneously requiring pollution controls and setting certain safety standards which reduced fuel efficiency and artificially holding down the price of gasoline. The results of this over-regulation in the auto industry had been to divert from the capital base very sizeable amounts of investment funds in an effort to meet governmentally mandated objectives—many of which had nothing to do with improving the quality or performance of the car in the consumers' eyes—and to raise car prices. (One study estimated that the anti-pollution regulatory standards, then applicable, increased costs by $1,400 per automobile.)

In order to respond to some of these longstanding problems, this Administration took several actions. A regulatory relief program was established which identified 34 auto industry-related regulations which were inefficient in a cost-benefit sense. However, the cornerstone of the President's initiatives on behalf of the industry was his economic recovery program. The President stated, "There is simply no doubt that revitalization of the economy is the single most important remedy for the auto industry's problems." The Administration also welcomed the Japanese export restraints as necessary to restore the confidence in the industry, if it were to undertake the steps required to make the transition to smaller, more fuel-efficient vehicles.

What have been the results of these actions to this date?

First, the industry responded by investing over $40 billion for capital improvements from 1981 through 1984 in order to modernize their facilities, improve productivity and develop and produce new models. To put this figure in perspective, auto industry capital spending as a proportion of sales was about 50 percent higher during this period than in U.S. manufacturing as a whole.

Second, U.S. small car capacity increased from 1.4 million units in 1978 to 3.9 million units in 1983. Output of more fuel-efficient, 4-cylinder engines with front-wheel drive transaxles increased from less than 10 percent of production capacity to about one third. And high technology electronics were incorporated to such an extent that the auto industry became the electronics industry's number one customer.

Third, changes in many of the government-mandated regulations applicable to the automotive industry have been completed resulting in estimated savings of billions of dollars to the industry and ultimately to the consumer.

With recovery of the general economy and with a cap on Japanese imports, the U.S. auto industry was well-positioned to benefit from increased auto demand over the last two years. U.S. car sales in 1983 were up 1.2 million units over 1982 with 87 percent of this increase going to domestic firms. In 1984, the picture was even brighter, sales were up another 1.2 million units with 97 percent of the increase going to U.S. firms. This resulted in a record nominal profit for the U.S. auto companies of $6.2 billion for 1983 and $9.8 billion in 1984. Even in constant 1978 dollars, last years profit figure would translate to $6.2 billion, well above the $4.9 billion level of 1978, the industry's last peak year.

Import market share, which had peaked at monthly levels in excess of 31 percent in 1982, has averaged 23.5 percent during 1984. Likewise, Japanese import share declined from 22.5 percent in 1982 to 18.5 percent in 1984.

Employment is, however, the measure of recovery and health which most of us consider of primary importance. Employment in the U.S. automotive industry, which had dropped from over one million workers in 1978 to less than 700 thousand workers in 1982, was again reaching over 900 thousand workers this January. Also, many of the U.S. auto jobs lost, were lost, not to imports, but rather to plant modernization, robotics and the shift in production to relatively smaller, less labor-intensive vehicles. These are jobs that would never have permanently reappeared in the auto plants, regardless of the level of imports, but have, in effect, reappeared in other industries and sectors. The economy as a whole has generated over eight and one half million jobs during the last six quarters, a period of extraordinary economic growth, giving further relief to those displaced from the automotive, as well as the auto supplying industries.

Four years ago, when the Administration instituted its program with respect to the auto industry and also accepted the Japanese voluntary restraints, there was an assumption that temporary market interventions by government were justified to counterbalance some of the previous governmental mistakes. These mistakes had disturbed the market and diminished the competitive ability of the U.S. auto industry. The actions taken were designed to lessen the effects of the unusual coincidence of severe structural pressures on the U.S. industry with a downturn in the business cycle and to get the weaker segments of the industry through a very rough period when massively increased capital requirements came during a period of financial losses. Compelled to make very aggressive capital investments with a shortfall in operating income, these companies took on substantially increased debt, in which both borrower and lender needed at least the psychological security that the U.S. market would not be inundated with imports.

The restraints on exports to our market were not without their costs. The U.S. International Trade Commission, as you are aware, recently released a staff study which estimated that the prices of domestically produced and imported Japanese cars increased by as much as $660 and $1,340, respectively, as a consequence of the four years of restraints. This results in an estimated cost to the U.S. consumer of almost $16 billion over the four years. Other economists using alternative assumptions and methodologies, that allow for the shift in consumer tastes back toward larger cars, have come up with somewhat lower consumer cost estimates—in the neighborhood of $500 per car. But there is no serious question that trade restrictions are costly to consumers.

Clearly there are also some ephemeral benefits to trade restrictions for the industries receiving the protection. The U.S. International Trade Commission estimated that the restraints resulted in sales of 1.2 million additional domestic autos over the last four years resulting in 44 thousand more automotive jobs. There were additional gains in automotive supplying industries. The Department of Commerce has estimated that the total employment gain to both the automotive companies and their suppliers resulting from the restraints to be in the range of 54 to 105 thousand jobs. But in citing these gains, it was also pointed out that the restraints exerted upward pressure on the exchange rates which would have resulted in hidden sales and job losses in the export and other import competing industries. While these losses were not estimated, the Commission stated that these job losses would have tended to offset some of the gains.

Another negative outcome was the economic rents accruing to the Japanese companies as a result of the temporary monopoly created by the restraints. The paradox is that the restraints were designed to aid the domestic industry, but, in fact, have increased the revenue of the Japanese producers, which can be plowed back into more innovation and productivity increases that, in turn, increase the long term competitiveness of the Japanese auto industry.

Proponents of auto trade restraints have generally advanced the following three major lines of argument for the continuation of such restraints: (1) The industry is still in need of temporary help, the original justification for the restraints. (2) The decision by some manufacturers on future investment plans, specifically on the degree of domestic sourcing versus outsourcing on new generations of small cars, the most competitive sector of the market, might be adversely affected by the expiration of restraints; and (3) With record U.S. trade deficits, both with respect to the world and in bilateral trade with Japan (of which the bilateral deficit in motor vehicle products was nearly $25 billion or 65 percent of the total), and the strong dollar, continuation of the auto trade restraints are still needed to avoid further increases

in this deficit, maintain domestic employment and exert pressure for more openness in the Japanese markets.

Let me address these arguments one at a time.

First, the general economy is now on a growth path that should continue for some time, if we are able to get the government's financial house in order and monetary policy continues on a steady plane. The U.S. auto industry has experienced increased sales and employment. Profits are at record levels in both nominal and real terms, and the companies' financial statistics show considerable strengthening since the last recession. It should be pointed out that this recovery in the fortunes of the U.S. auto industry has been during a period when it was shielded from its fiercest international competitor, but I think it is fair to say that the industry has gotten over a particularly difficult period and can reasonably be expected to stand on its own competitive abitities. In sum, the original purposes of the restraints, to any rational observer of the current state of the economy and the auto industry, have been fulfilled.

Second, if the industry is now able to compete, should the government intervene in the private decision-making process to encourage or discourage specific investment programs, particularly in small cars? Such a course of action is certainly beyond the scope of the original intentions of the restraints. More importantly, it would be substituting the judgment of politicians and bureaucrats for that of the market place. It should surprise no one that I and most of my colleagues in this Administration believe that the auto industry, itself, must decide what future product and investment plans to follow in an open trading environment. To do otherwise could create demands for permanent protection to justify actions that might not otherwise be economically viable.

Turning to the third argument, it has always been popular to support trade restricting actions by citing balance of trade or payments arguments. It is true that the "soaring dollar" does have adverse consequences for our exporting and import-competing industries. In fact, all the gains the auto industry has made in cost savings over the last four years have probably been wiped out by the simultaneous decreasing value of the yen. In a technical sense, the relatively high value of the dollar is largely responsible for our current trade difficulties. But it does not necessarily follow that we should take border actions, as opposed to more sensible actions within our borders to correct the underlying macro-economic conditions which have so appreciated the dollar.

At the heart of the problem is the fact that we as a nation are not saving sufficiently to meet the investment needs of our expanding economy. The gap between what America has been willing to save and wanted to invest has been filled by borrowing from abroad. As foreign investors buy dollars to invest here, they bid up the dollar's value in foreign exchange markets, making imports cheaper for our citizens and exports dearer abroad. When all the figures are in for 1984, we will show a current account deficit slightly in excess of $100 billion, financed by a like amount of net capital borrowing from abroad.

It is also true that the resistance of the Japanese market to imports has also been an important factor in the U.S. trade deficit. Between 1982 and 1984, the U.S. trade balance with Japan deteriorated by $18 billion, from a bilateral U.S. deficit of $19 billion to $37 billion. U.S. exports to Japan increased only $2.6 billion, while U.S. imports from Japan increase by over $20 billion. Undoubtedly, the exchange rate was the most important cause of our worsening trade position with Japan; nevertheless, market access problems were also a significant factor. It is absolutely critical that we reach an effective understanding soon with the Japanese on the serious problems of access to the their market.

I and some of my colleagues, as well as many members of Congress are rapidly losing patience with the slowness of the market opening process in Japan, particularly when that nation enjoys such a significant trade surplus. We are tired of hearing arguments that it is all a result of the highly valued dollar or our businessmen not trying hard enough. Although some part of the problems can be attributed to these causes, we also had access problems in many Japanese markets when the dollar was lower, as today do other countries, even those whose currencies have fallen sharply against the yen.

Over the last twelve years, I and my esteemed predecessors as the President's chief trade negotiator have concluded innumerable trade agreements with the Government of Japan. The net result of these efforts has been to increase the flow of paper and diplomats between our two countries, but not to increase significantly our exports of goods. In addition to the obvious cost in lost trade, these past efforts have often led to public rancor and disrupted the close and friendly relations which have been developed over the last twenty-five years.

Many in our government have always believed that quiet diplomacy would finally result in freer trade between our two nations, but recent history has shown that the market opening gestures from Japan have only been forthcoming after public and Congressional clamor was raised in the U.S.—and usually even then, in form rather than substance. We are committed to change this too familiar pattern.

I am convinced that most responsible Japanese leadership wants to truly open their markets, but that the political realities of their country have continually frustrated that objective, to the detriment of our mutual trading and political relationships. To continue the auto restraints, supposedly in order to increase our leverage in the current market opening discussions, as some have argued would simply be to play into the hands of the protectionist elements in Japan. I believe that they would like nothing better than to justify their continued obstinate stance in markets from lumber to pharmaceuticals to telecommunications equipment, where the U.S. has competitive advantage, by citing their nation's own sacrifice in continuing the automotive export restraints. Restraints not withstanding, Japanese automotive exporters would, in any case, expand their sales to the U.S. market by billions of dollars, because of the increased parts exports needed to support both the much expanded Japanese-origin auto fleet and the new Japanese subsidiary automotive assembly facilities in this country.

The seduction of protected home markets should not be allowed to interfere with the commitment Japanese and U.S. leadership has made at the highest level toward free and fair trade between our two countries. Following the course of continued auto restrictions could cause us to lose on all counts: no improvement in Japanese market access, no improvement in the bilateral balance of trade, no improvement in the long term competitive situation of the domestic auto industry, additional costs and limitations in choice for the American consumer and a backing away from freer trade, that has helped curb our domestic inflation and supported the current resurgence in the international economic system.

Mr. Chairman, we have learned from experience that U.S. industry stays competitive, efficient, profitable, and growing, when it must make the tough decisions and necessary investments that come from a competitive environment. One past mistake was that we had allowed some industries to get lazy. We cannot let this happen again. Our future national well-being depends upon our ability to meet the competition, not be isolated from it.

TABLE I.—VALUE OF TRADE IN NEW PASSENGER AUTOMOBILES

[In billions of U.S. dollars]

Year	U.S. imports from the world [1]	U.S. imports from Japan	U.S. exports to the world [1]	Trade balance
1970	1.373	.456	.114	−1.259
1971	2.737	.529	.124	−2.613
1972	3.111	1.138	.122	−2.989
1973	3.716	1.244	.215	−3.501
1974	4.454	1.686	.347	−4.107
1975	4.198	1.742	.427	−3.771
1976	5.327	2.855	.566	−4.761
1977	6.791	3.860	.637	−6.154
1978	9.583	5.771	.956	−8.627
1979	10.982	6.471	1.323	−9.659
1980	12.877	8.229	.884	−11.993
1981	13.427	9.491	.765	−12.662
1982	14.392	9.608	.517	−13.875
1983	17.459	11.441	.346	−17.113
1984	19.169	12.349	.348	−18.821

[1] Except Canada

Source: Ward's Automotive Reports

TABLE II.—RETAIL SALES OF NEW PASSENGER AUTOMOBILES

[In thousands of units]

Year	Domestic [1]	Imported [2]	Imports from Japan	Total
1968	8,418	960	113	9,378
1969	8,385	1,044	191	9,429
1970	7,157	1,261	313	8,418
1971	8,263	1,541	552	9,804
1972	8,958	1,592	615	10,550
1973	9,631	1,753	742	11,385
1974	7,332	1,409	597	8,741
1975	7,050	1,580	817	8,630
1976	8,607	1,499	938	10,106
1977	9,104	2,069	1,388	11,174
1978	9,308	1,976	1,337	11,284
1979	8,225	2,304	1,749	10,530
1980	6,578	2,363	1,882	8,941
1981	6,206	2,327	1,859	8,533
1982	5,757	2,223	1,798	7,980
1983	6,795	2,386	1,877	9,182
1984	7,951	2,418	1,906	10,369

[1] Domestic automobile sales include U.S. and Canadian built automobiles sold in the United States.
[2] Does not include automobiles imported from Canada.

Source: Ward's Automotive Reports.

TABLE III.—VALUE OF TRADE IN MOTOR VEHICLE PARTS

[In billions of U.S. dollars]

Year	U.S. exports from the world [1]	U.S. imports from Japan	U.S. exports to the world [1]	Trade balance
1970	.571	.164	.952	.381
1971	.750	.213	.942	.192
1972	1.134	.408	1.015	−.199
1973	1.601	.579	1.246	−.355
1974	2.157	.886	1.809	−.349
1975	1.857	.741	2.322	.465
1976	2.801	1.343	2.497	−.305
1977	3.473	1.584	2.543	−.929
1978	4.991	2.480	2.484	−2.507
1979	5.673	2.665	3.156	−2.516
1980	6.027	2.791	3.883	−2.144
1981	4.551	1.822	5.067	.516
1982	4.587	1.822	4.259	−.328
1983	6.029	2.112	3.273	−2.756
1984	8.253	2.940	4.156	−4.097

[1] Except Canada.

Source: U.S. International Trade Commission.

TABLE IV.—VALUE OF TRADE IN AUTOMOBILE TRUCKS [1]

[In millions of U.S. dollars]

Year	U.S. imports from the world [2]	U.S. imports from Japan	U.S. exports to the world	Trade balance
1970	2.853	.116	172.633	169.780
1971	28.943	26.432	163.575	134.632
1972	117.448	116.594	158.757	41.309
1973	60.863	59.147	202.675	141.812
1974	40.993	40.466	298.533	257.540

TABLE IV.—VALUE OF TRADE IN AUTOMOBILE TRUCKS [1]—Continued

[In millions of U.S. dollars]

Year	U.S. imports from the world [2]	U.S. imports from Japan	U.S. exports to the world	Trade balance
1975	5.385	5.160	924.255	918.870
1976	1.093	.894	715.560	714.467
1977	1.048	.955	691.876	690.828
1978	1.828	1.385	919.755	917.927
1979	25.580	25.341	909.577	883.997
1980	375.866	375.726	1,143.118	767.252
1981	1,816.782	1,811.977	1,208.221	−608.561
1982	1,507.934	1,486.753	1,263.000	−244.934
1983	1,763.280	1,755.177	644.049	−1,119.231
1984	2,418.00	2,355.00	.502	−1,916.000

[1] Data includes lightweight cab/chassis which were reclassified as unfinished trucks (692.02) during 1980 by the U.S. Customs Service.
[2] Except Canada.

Source: Ward's Automotive Reports.

TABLE V.—*U.S. employment, annual average for the motor vehicles and equipment industry*

[In thousands]

1972	874.8
1973	976.5
1974	907.7
1975	792.4
1976	881.0
1977	947.3
1978	1,004.9
1979	990.4
1980	788.8
1981	783.9
1982	690.0
1983	757.8
1984	[1] 867.3

[1] These figures are preliminary.

Source: Bureau of Labor Statistics.

U.S. employment, monthly figures for 1984 and 1985 year to date for the motor vehicles and equipment industry

[In thousands]

1984:	
January	833.3
February	852.1
March	863.0
April	855.0
May	856.0
June	865.0
July	870.0
August	862.0
September	864.0
October	865.0
November	877.0
December	[1] 906.0
1985: January	[1] 921.0

[1] These figures are preliminary.

Source: Bureau of Labor Statistics.

TABLE VI.—*U.S. employment, annual average for all manufacturing industries*

[In millions]

1972	19.15

1973	20.15
1974	20.08
1975	18.32
1976	19.00
1977	19.68
1978	20.50
1979	21.04
1980	20.29
1981	20.17
1982	18.78
1983	18.50
1984	[1] 19.59

[1] These figures are preliminary.

Source: Bureau of Labor Statistics.

TABLE VII.—*U.S. employment, monthly figures for 1983 and year-to-date 1984 for all manufacturing industries*

[In millions]

1983:	
January	17.87
February	17.88
March	17.96
April	18.09
May	18.27
June	18.53
July	18.46
August	18.71
September	18.97
October	19.05
November	19.09
December	19.09
1984:	
January	19.30
February	19.38
March	19.47
April	19.53
May	19.57
June	19.63
July	19.70
August	19.72
September	19.61
October	19.69
November	19.72
December	[1] 19.81
1985: January	19.83

[1] These are preliminary figures.

Source: Bureau of Labor Statistics.

TABLE VIII.—U.S. UNEMPLOYMENT

[Percent]

	All civilian	Manufacturing	Auto manufacturing
1972	5.6	5.6	4.4
1973	4.9	4.3	2.4
1974	5.6	5.7	9.3
1975	8.5	10.9	16.0
1976	7.7	7.9	6.0
1977	7.0	6.7	3.9
1978	6.0	5.5	4.1
1979	5.8	5.5	7.5
1980	7.1	8.5	20.3
1981	7.6	8.3	14.6
1982	10.8	14.8	23.0

TABLE VIII.—U.S. UNEMPLOYMENT—Continued

[Percent]

	All civilian	Manufacturing	Auto manufacturing
1983	9.6	11.2	12.6
1984	7.2	7.5	7.2
1985: January	7.4	7.6	6.2

Source: Bureau of Labor Statistics.

TABLE IX.—*U.S. unemployment, monthly rates for 1983 and 1984 and year-to-date 1985 for the auto manufacturing industry*

[In percent]

1983:	
January	16.9
February	16.9
March	15.5
April	15.8
May	14.7
June	13.9
July	10.7
August	10.3
September	11.3
October	10.7
November	9.4
December	5.5
1984:	
January	6.4
February	5.4
March	5.8
April	6.3
May	8.0
June	7.7
July	6.4
August	8.5
September	10.3
October	8.8
November	6.7
December	4.1
1985: January	6.2

Source: Bureau of Labor Statistics.

Chairman GIBBONS. Thank you, Mr. Ambassador. Before I begin my questioning let me state to the committee members that I tried to note the order in which you came in. I think I have the order correct. If I am wrong please let the staff know, and we will correct the ordering.

I have Mr. Crane coming in first, Mr. Schulze, Mr. Jenkins, Mr. Guarini, Mr. Pease, Mr. Downey, Mr. Gephardt, Mr. Frenzel, Mr. Vander Jagt, and Mr. Fowler. Excuse me, Mr. Heftel, I did not see you down there.

Mr. Ambassador, I believe these restraints have cost the American consumer a considerable amount of money. Do you agree with that?

Ambassador BROCK. Absolutely.

Chairman GIBBONS. How much do you think it has cost the American consumer?

Ambassador BROCK. The low figure I have seen is about $500 a car. The high figure is about $1,400. I think it is probably somewhere about half way between.

Chairman GIBBONS. Repeat those figures again for me.

Ambassador BROCK. The lowest estimate I have seen is $500 a car. The high figure was around $1,400 a car. So let us take something on the order of $700 or $800 a car as a best guess.

Chairman GIBBONS. It is also my belief that these restraints have really put the Japanese automobile industry in a better competitive position than they were before the restraints were put on. Is that your conclusion?

Ambassador BROCK. Oh, of course. Most of their profits, if not all, are earned in the U.S. market because, you see, the Japanese have a different tax system, Mr. Chairman. They have a commodity tax on cars that runs from 18.5 percent to 23 percent. That pays the cost of government if they are selling their cars in Japan, but that tax is rebated at the border. So those cars pay no tax if they are sold in the United States. And that is a substantial incentive for exports.

But it also dampens the domestic demand in Japan for cars. Therefore, they make very little money in Japanese sales in the Japanese market. They make their money here and that money is plowed back into R&D, productivity improvements, new technology that will enable them to remain very, very competitive.

Chairman GIBBONS. Now, obviously, these restraints seem to have helped General Motors, Chrysler, Ford, and the UAW become stronger and more competitive in their own area. But what has been the impact on the rest of American industry?

Ambassador BROCK. Well, every dollar that you pay in additional costs as a result of Government intervention is a dollar that can't be spent for shirts or shoes or other items that the consumer might want to buy. So it does have the effect of disadvantaging people in other industries.

I think the American people were ready in 1981 to take some steps to assist the automobile industry, which was caught in a trap not entirely of its own making. The Congress, previous administrations had imposed enormous burdens on the industry with new regulations, very expensive, as I noted in my testimony. One of the regulating environmental controls I think cost something like $1,400 a car by one estimate.

That is a pretty heavy burden for them to take and then when they were caught in the additional trap of the Irani and Iraqi war which caused all the gas lines to form and people completely shifted their buying habits overnight, there was an argument for giving some time to adjust to the new situation.

But the cost was stated at the time as one that would achieve higher prices and it did and I think people now wonder whether that's continued to be justified.

Chairman GIBBONS. Now, Mr. Ambassador, has the administration been considering these voluntary restraints and what to do about them?

Ambassador BROCK. Very actively so, Congressman.

Chairman GIBBONS. Has the administration taken a formal position yet on these restraints?

Ambassador BROCK. We have not. The Cabinet has met on a number of occasions. We have discussed it at length. We have had a number of studies, but no final recommendation has gone to the President as of this hour and he has not made a firm decision.

Chairman GIBBONS. Are you at liberty to say when the President may receive this and when he perhaps may make a decision?

Ambassador BROCK. No, but I would assume it will be very soon.

Chairman GIBBONS. Thank you, Mr. Ambassador. Mr. Crane?

Mr. CRANE. Thank you, Mr. Chairman. You estimated that Japanese auto exports to this country might increase by 750,000 units the first year VRA is lifted. That would mean nearly a 40-percent increase over the current level of about 1.9 million units.

I am curious how you arrived at that estimate. Does it repesent a figure presented to you through discussions you may have had with the Japanese Government or Japanese industry officials or domestic industry officials?

Ambassador BROCK. All of us in this business lack the credentials in prophecy that we would like to have. I certainly do myself. The varous estimates that I have seen, the Department of Commerce estimated that the number might be 400,000 units in 1985, 800,000 in 1986. The ITC estimated an increase of 1 million units. The UAW increase estimate ranged from 500,000 to 1 million, CEA was about 600,000.

The Japanese have indicated that they thought—at least some have indicated to me—that they thought the figure might reach 2.6.

Mr. CRANE. My understanding, Mr. Ambassador, is that the Japanese auto companies as well as the domestic auto producers prospered enormously under these voluntary restraints, that the Japanese, while holding fast on the number of exports to the United States, followed the U.S. auto companies' lead in significantly increasing the price and thus the profit margin.

And you indicated already that they plowed much of that back into further advancements in quality and research and development of their products. I am curious as to whether you see a significant motivation on the part of the Japanese to alter this situation. It would seem to me a better deal—they have the same number of units coming in here but their profits are significantly greater. Are you confident that the market forces are going to adjust for that for the benefit of the consumer?

Ambassador BROCK. Congressman, you and I both know that there are an awful lot of business people that just love a monopoly situation. And that is what we gave them. But let me draw the distinction and answer, yes, I am confident for a reason. While the top two or three Japanese manufacturers walked into a gravy train that was just glorious for them, the smaller manufacturers got no such opportunity at all because they were frozen out of the market: Isuzu, Suzuki, Subaru, Mitsubishi. Some of those firms were frozen at a very, very low share of the market. And those are pretty tough little firms. They are ready to compete. I think what you are going to see if the restraints are lifted is a very aggressive action by the smaller manufacturers to grab back some of that market share that was deprived them by government action, not by dint of competition.

So it is my judgment that while some in Japan probably would dearly love to see these things continued, probably with a slight increase, others are desperate about getting them removed. So the competition will work.

There is a subject that came up yesterday, when Secretary Baker was testifying before the committee, and it was, it seemed to me a contradiction between the positions taken by former Treasury Secretary Don Regan, and Republican Senate leader, Bob Dole.

And Regan said that it was his hope to try and establish the Tax Code that was simplified, equitable, neutral, fair, et cetera.

And Bob Dole said that he was less confident of that. He thought that providing tax incentives to achieve certain social objectives, was preferable to creating programs.

Congressional Research Service indicates that one of the reasons for the Japanese success in being intensely competitive is significantly reduced taxes on their industries, versus what we impose on our own.

You add to that the problems that the American auto industry has had to contend with, with some capricious and arbitrary regulations and emissions standards and what have you, when at the time that we made those profound judgments in Congress, I do not think that there was a single engineer—a person with an engineering background who served in either the House or the Senate, but we played engineer with the auto companies at quite considerable expense.

Are these not, in part, the problems of the auto industry, here at home, self-inflicted wounds, not self inflicted by the auto industry, but by self-inflicted, I mean in terms of our decisionmakers here in Congress.

And oughtn't we, perhaps when we take up the broader question of tax legislation, do some more intensive study of the advantages the Japanese may have because they have a government with a more compassionate interest in guaranteeing the survival of their industry by minimal tax burdens imposed on those industries, that ultimately have to be passed on to the consumer anyway?

Mr. SCHULZE. Absolutely. I could not more strongly agree that the decision to compete has to be made by the United States and it has to be made at the level of government as well as business. And that to me argues that the two most important single actions the Congress and the administration can take this year are first: To remove the burden that the Federal deficit is imposing upon our enterprise system and consumers and taxpayers. And second, to radically reshape the tax system so that we maximize savings and investment in order to give our workers the tools with which to compete. That is the way that you do it.

And if I may, I would give you just one point of elaboration, Congressman, as an example of what you can anticipate if the restraints are lifted.

I mentioned the small companies in Japan. They are not so small. They are going to sell several hundred thousand units in the U.S. market, if my evaluation is anywhere near accurate. But what they are going to do is that they are going to surge into the U.S. market at the small car end, because that is where they have their

product mix. That is going to take away sales of small cars from U.S. manufacturers.

And what I expect that is going to do is to throw at least two of our manufacturers into absolute, overt violation of the CAFE standards.

So the automobile manufacturers are going to be faced not only with competition from Japan, but with substantial penalties imposed by the Congress on a per-car basis.

Mr. CRANE. Thank you, Mr. Ambassador, I appreciate your testimony.

Chairman GIBBONS. Thank you, Mr. Crane.

Mr. Schulze, before I call on you, let me ask the staff to please activate the electronic timing device to help all of us to stay within the time limit. Ambassador Brock, you are going to be a very popular witness. We may have to invite you to come back on this very subject very soon.

Ambassador BROCK. I would be very happy to do so.

Chairman GIBBONS. Mr. Schulze?

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Ambassador, you had discussions with the Japanese earlier this month. Were there any indications then of their reactions depending upon the move that we make on this issue?

Ambassador BROCK. The signals have been a bit mixed Congressman. Some have pressed very hard for removal of restraints and frankly we are both very honest in saying that if restraints were removed that the sales would balloon very quickly.

Others suggested in various ways that they were going to have to continue to try to be prudent. And that the surge would be something less than the number that I might have mentioned or even higher figures mentioned by others.

So I am not sure that I have a very clear picture of what, in fact, the decision might be.

Mr. SCHULZE. One of the Japanese practices which has concerned me greatly over the years, was that they would protect a domestic market until the producers were competitive on the world market and then turn them loose.

Aren't we to a degree doing the same thing with the VRA?

In other words, protecting our domestic market until they were competitive?

Ambassador BROCK. That is in essence what was done with the voluntary restraints.

Mr. SCHULZE. Do you think that they are in a position now, after having had this protection for these years to go out on their own?

Ambassador BROCK. Yes, I do.

Mr. SCHULZE. Do you think that the impact will be small enough that it can be taken up by other peripheral industries or do you think that we should just not worry about those people?

Ambassador BROCK. I think that the impact could be taken up by a healthy economy, which we anticipate will continue if we can reach an agreement about solving our fiscal difficulty.

But I should point out, Congressman, that there is going to be a change in this and similar industries throughout the land for the forseeable future as new technology and productivity improvements are put into place. It is my belief that we will have more

people moving out of jobs because of changes in technology and productivity than because of imports.

So I think that we have to have a healthy enough economy to allow that adjustment to occur.

Mr. SCHULZE. Since we do have such a large trade deficit and I know your frustration and many of us are frustrated over the apparent lack of cooperation from the Japanese in doing something about our trade deficit our bilateral trade deficit, would you give me your thoughts on a 20- or 30-percent ad valorem tax that we could apply that would help our budgetary problems, give us some money to help to get the budget in balance?

And also would regulate the trade imbalance at the same time?

Ambassador BROCK. There is a considerable surface appeal to the suggestion of an across-the-board surtax, until you examine its consequent economic effects. The appeal comes from the double whammy that you get. You obviously would put a substantial dent into imports, with an amount of that size, and you would probably contribute $60-plus billion to the reduction of your deficit.

But the down side, Congressman, is that the dollar, in my judgment and in the judgment of a number of economists, would adjust and strengthen. The problem that we have now is a strong dollar.

If we made it even stronger, it would offset the value of that surcharge. So all that we would be left with then is more inflation, and a substantial reduction of exports.

I think that, you know, the first people that would be hurt, for example, would be farmers, in the most price sensitive of all areas, and they are already desperately in trouble.

So I am cautious about anything that would represent an across-the-board attack like that.

Mr. SCHULZE. You think that the farmers would be hurt because of retaliation, or because of the resultant inflation?

Ambassador BROCK. The first result would be an increase in inflation and an increase in the value of the dollar which would make their products even less price competitive than now.

Mr. SCHULZE. I will make you a little wager right here: The dollar is going to continue to increase. It is not going to fall even if we reduce the deficit. In my opinion this is not a temporary phenomenon and I am one who had been saying that this is cyclical, and it is going to straighten out.

I am now convinced that it is not going to straighten out, after being through Europe and talking to Finance Ministers, I believe it is going to be something that is with us for a long time and if it is going to adjust, we are going to have to do it. I don't think that the markets are going to do it.

Ambassador BROCK. I accept that. I, personally, have been saying for 3 years that I thought the dollar was going to go up each year, in the trade sense, and unfortunately I have been right.

The fact is that the dollar is reflecting the strength of the U.S. economy relative to other economies and we are by far, the strongest economy in the world.

Mr. SCHULZE. Thank you, Mr. Ambassador.

Chairman GIBBONS. Mr. Guarini.

Mr. GUARINI. Yes; I would yield to Tom Downey for a moment.

Chairman GIBBONS. Mr. Downey.

Mr. DOWNEY. Thank you.

And I want to thank you for yielding.

I am just going to ask Ambassador Brock one question.

I could not agree more with most of the things in your statement, Mr. Ambassador, and also with the fine job that you are doing.

And your last paragraph on page 8, is, I think especially persuasive about what our country and what our economy needs, in terms of the cold water of free trade to keep us awake and keep us on our toes.

What I am concerned about is an article that appeared on February 26, in the Post, that the United States delays trade talks with Japan, Baldrige refuses to send top aide to the Tokyo meeting.

Is this a coordinated strategy?

I mean, on the one hand, you are talking about removing the voluntary trade restraints or thinking about it, in the sense that as a gesture to the Japanese, we would not appear protectionist and that they should not be. I laud that.

On the other hand, we are not sending people to talk to them because of the stall in talks over telecommunications. I do not know what we should do, I just want to make sure that you and Mac Baldrige and others are working from the same agenda, because I am not sure that what you are testifying here today, and what they are doing on telecommunications, is the same policy.

Ambassador BROCK. We are working from a coordinated strategy. I won't refer to that particular incident, except to say that all that he was doing was reflecting a frustration that most of us who have been feeling with this issue feel.

It is a fact that we have been trying to get from the Japanese, a copy of their proposed ordinances which would go into effect on April 1 for some time.

And he reached the conclusion that there is not a whole lot of sense in talking about something if you do not know what you are talking about, if you do not have something tangible to look at. And until we saw those ordinances, it did not make much sense to send Mr. Olmer back over.

I point out, that literally that week, Japanese officials, officials at the senior level, the No. 2 person in the Ministry of Post and Telecommunications was in Washington. I met with him and my deputy Mike Smith met with him and I assume that he met with Commerce officials as well. And the talks are ongoing but I think that Mac was generally just saying that he was a bit weary of the delay.

Mr. DOWNEY. Mr. Chairman, I would ask unanimous consent to yield my time to Mr. Guarini.

Chairman GIBBONS. Sure.

Mr. Guarini, you have whatever is left of Mr. Downey's time plus your own time.

Mr. GUARINI. Thank you, sir.

Mr. Ambassador, the imports from Japan have risen in the last few years, from $30 billion to $60 billion and at the same time, our exports to Japan have gone from $20 billion to $22 billion.

And so we see now that there is a gap of $37 or $38 billion. Thirteen billion of it is automobile sales, a good part of it, because they hardly buy any cars from us at all—I understand 2,000 units.

This does not seem to be a very friendly trading partner, because they must understand what this is doing to our economy. And I am just wondering whether or not, how do other countries handle this problem?

England, I understand, does have quotas. Other countries of the world do take action to prevent overpenetration by Japan. Could you shed some light on how this problem is handled by the other nations of the world that might be placed in a similar position by Japan?

Ambassador BROCK. In Europe generally the import penetration of Japanese cars is limited to somewhere between 10 and 11 percent. It is about 10 or 11 in Great Britain, slightly more than that in Germany and the Benelux countries. In France they hold the Japanese to about 3 percent, and in Italy it is somewhere around 1 or 2 percent.

Mr. GUARINI. Is that by law or is that voluntary restraint agreements by Japan?

Ambassador BROCK. There are some of both, but most of the actions were taken unilaterally by Europe. A couple of those were negotiated with the Japanese.

Mr. GUARINI. Now, when we asked for these restraints and quotas, we felt it was an emergency and it would give the American automobile industry enough time to right itself. And now, of course, 4 years have gone by.

Do you feel that the American automobile industry has acted responsibly and has developed a strategy and a program for the future and that they can be at parity with Japan?

Ambassador BROCK. Yes; I think they have done a remarkably good job. I think business and labor both have contributed significantly. Business management has invested over $40 billion. Labor has exercised for most of this period of time a very significant restraint in wage patterns. And both have worked very hard at improving work rules to increase the productivity and to reduce absenteeism. There remain problems, but they have made a good deal of progress, and as far as I am concerned the opportunity for competition is there.

Mr. GUARINI. Are we being taken advantage of by Japan's commodity tax system where it puts us in an extreme disadvantage because of the rebates?

Ambassador BROCK. Yes; I do not know that you would say taken advantage of. It is something the United States agreed to 20 or 30 years ago. I very much regret that decision, but the fact is we agreed with the rest of the world's insistence to allow the rebate of commodity taxes at the border, of value added taxes at the border.

And, therefore, most countries have adopted a value added tax system of varying degrees because of the significant advantage it gives to an exporting firm. The United States has never followed that pattern, and that has been one of the reasons why we have been the surge recipient from so much of the world.

Mr. GUARINI. Would we have an opportunity of renegotiating this with another round of GATT, or is there any way we can get out of the box that we painted ourselves into?

Ambassador BROCK. It is very difficult. Right now a lot of them are laughing all the way to the bank. So it would be—I do not know what we would have to pay them to put it in trade terms—I do not mean cash—to motivate them to change those systems. They happen to be happy with them. They work for them. And they say if the United States wants a different system we have every right to have it.

Mr. GUARINI. Well, a deal is a deal, but perhaps it does not last forever. I should imagine there should be a lot of things that should change in international trade. Let me ask you, is there any planning or strategy that is being used to avert another disaster that we may have from the Korean cars, the Ponies or the Yugoslavian cars, the Yugos, that I understand have already penetrated 11 percent of the market in Canada and that will be coming over here where 2,500 dealers have already applied for dealership?

Ambassador BROCK. Those cars are priced at a very popular level. The Yugo will sell in the $3,000 to $4,000 range, maybe slightly higher. The two Korean cars probably will sell in the $5,000 to $6,000 range. There is an enormous market for that price car in the United States from people that find it difficult to buy cars at the $8,000 and $10,000 level.

I have trouble answering your question because I guess I do not believe competition necessarily constitutes a crisis. I think it is something that the industry has to deal with.

Mr. GUARINI. Should we plan to have a strategy for the future or wait until we get inundated and then end up in a worse mess than we are in now?

Ambassador BROCK. Well, that is a question you should ask Mr. Iacocca, Mr. Smith, and Mr. Caldwell. They are the ones that have to compete.

Mr. GUARINI. But what I am saying is that if you are paying $3 an hour to a worker in a plant in Korea and that same person in the United States is getting maybe $18 or $20 an hour I do not know how we would ever be competitive no matter what happens to the value of the dollar or what happens to the balancing of our budgets.

These things could be beyond our control unless we have some kind of strategy for the future.

Ambassador BROCK. I do agree that the firms should have a strategy for the future. I, personally, believe that that is what GM has tried to establish with their Saturn project. I am sure the other three major automobile producers in the United States are trying to devise similar approaches. I do not know whether they have made decisions yet, but I do not believe that Government can make those decisions for business.

If they cannot do it for themselves we probably would not do much better.

Mr. GUARINI. Do you agree that Government, labor, and business should work closer together if we are to develop a national strategy and policy?

Ambassador BROCK. I think we should work together to develop macroeconomic policies that would allow the system to work better.

Mr. GUARINI. Thank you.

Chairman GIBBONS. The next member is Mr. Pease.

Mr. PEASE. Thank you, Mr. Chairman. Welcome, Mr. Brock, back to the committee.

According to the information we have the ITC has said that the voluntary restraints have cost consumers about $4 billion a year. Is that consistent with figures you have seen?

Ambassador BROCK. Yes; but it is frankly a bit higher than some I have seen.

Mr. PEASE. Pardon me?

Ambassador BROCK. It is a bit higher than some, but that is within the range.

Mr. PEASE. So it is up to $4 billion a year for consumers.

Ambassador BROCK. That is right.

Mr. PEASE. I understand that the Commerce Department has estimated that if the VRAs are lifted Japanese market share could go as high as 34 percent and that 110,000 American jobs could be lost by 1987. Is that consistent with your information also?

Ambassador BROCK. That is correct. I think if you are using the 110,000 number you have to include both the basic industry and their suppliers. That includes first and second tier effects.

Mr. PEASE. If I take 110,000 jobs lost within the next 2 years and multiply that by what is probably the average wage in the auto industry of about $40,000, that turns out to $4.4 billion lost in wages for auto workers and their suppliers in this country.

What do we do with those unemployed auto workers and how do we cope with that much money not going into the American economy in terms of the loss of wages to those auto workers, the cost to the Government of the loss of their tax money, the cost of unemployment compensation, the cost of food stamps, the cost of welfare, and so on.

Is that not a very substantial cost also for giving up the VRA's?

Chairman GIBBONS. Excuse me. Before the Ambassador answers that, did you say $40,000?

Mr. PEASE. Yes.

Chairman GIBBONS. That is a higher figure than I have heard used.

Mr. PEASE. I have got a lot of auto workers in my district and I think $40,000 would be about the right figure.

Ambassador BROCK. The wage would come closer to $50,000 than $40,000.

Mr. GIBBONS. Per worker per year?

Ambassador BROCK. Yes. I think that is a high cost, Congressman, but I want to just turn the question and ask you, since the average person in this country makes half of that, should they be required to subsidize the continuation of jobs in that industry by an action of the U.S. Government.

Mr. PEASE. Well, I know that is a sensitive question, and the subsidy, though, if there is one in terms of when people buy cars is spread out over 240 million Americans, or 10 million purchasers of cars a year.

But I guess the point I am trying to make is a lot of people talk about costs to consumers in our country, and there is a cost; there is no doubt about that. But I just want to emphasize that there is a cost on the other side, too. If 110,000 auto workers are not working or have been able, half of them, to find jobs at the minimum wage, there are an awful lot of purchases of the products made by other Americans which are not getting made. And there is a ripple effect, as you well know, not to mention the direct effect on the revenue of the Government and on the outlays of the Government.

Ambassador BROCK. I accept that. I think you do have to look at it from that point of view. But again, the estimates I have seen would indicate that the restraints may have saved, in the last 4 years, something like 44,000 jobs.

Now, you are talking about the threat of unemployment; I am talking about the actual new jobs that might have been created, and to use your same numbers, if you created 44,000 jobs with $4 billion per year, that is an absolutely awesome amount of burden to put on people that are making $10,000 and $15,000 and $20,000 a year, some of whom absolutely have to have a car in order to get to work. They need some opportunity to be considered in the process, too.

Mr. PEASE. But well, I think it is fair enough to say that the people who absolutely have to have a car, and who are only making $10,000 or $15,000, will be lucky to buy either a Japanese car or an American car. They will be the market for the Yugoslavian cars and the Korean cars, which will soon come flooding into our market and probably torpedo the efforts of American companies to even try to get into the small car market.

Ambassador BROCK. But will we then be asked to restrain them, Congressman?

Mr. PEASE. I would not be surprised.

Ambassador BROCK. Then what do you say to the $10,000 and $15,000 worker?

Mr. PEASE. I want to say just one thing, Mr. Chairman, and I will try to do it in 10 or 15 seconds. You say that rather than take direct action to redress our trade imbalance, we ought to do more sensible actions within our borders to correct the underlying macroeconomic conditions which have so appreciated the dollar. I could not agree more, but let us be realistic about it. The President's budget for next year does not do that, nor for the year after that or the year after that or the year after that.

We are talking about a long-term problem before we get our Federal deficits under control, and I do not think we can say let us wait until we take care of these macroeconomic problems.

That is a statement, really, more than a question.

Thank you, Mr. Chairman.

Ambassador BROCK. If I may, Mr. Chairman, I would like to just comment very briefly.

I understand what you are saying, but I do not believe that the fact that the President's program would take the deficit from 4 percent to 3 percent to 2 percent to 1 percent of GNP argues that we have to wait for 4 years for any economic impact.

Part of the problem in dollar valuation and in interest rates is anticipation. If people believe that the Congress and the adminis-

tration can work out a deal to make a commitment to pull this deficit down regularly and predictably, by whatever combination of mix that we can jointly agree upon, I think we will have a substantial reduction in interest rates in the near term.

Mr. PEASE. Mr. Ambassador, we are getting off the subject a little bit, but the Washington Post this morning reports that the CBO has reestimated the President's budget, and the deficit will be between $180 billion and $190 billion, even if the President's cuts are made for the rest of the decade. That is a long time.

Chairman GIBBONS. Could we get back to something just a little closer to the subject at hand?

Ambassador BROCK. Both those statements simply argue for more effective action now.

Chairman GIBBONS. I want to give Mr. Gephardt the floor now.

Mr. GEPHARDT. Thank you, Mr. Chairman.

Mr. Ambassador, welcome to the subcommittee. I have three quick questions I would like to ask.

First, spokesmen for the Japanese auto industry say that they will be constrained by their capacity to produce and sell in this country more than 2½ million cars. The Department of Commerce here says that that capacity is really more like 3 million, rather than the 2½ million that the Japanese spokesmen have talked about.

Do you have an opinion as to what their capacity is to export cars to the United States?

Ambassador BROCK. I would put it closer to 3 million than to 2½, and frankly, my own judgment is that it could be higher than that, and they could move to overtime. If they really wanted the market, they could grab a very significant share.

Mr. GEPHARDT. What share do you think they would achieve assuming the economy stays fairly constant, if the VRA is taken off? What share would they achieve in the year following its coming off?

Ambassador BROCK. In the first year?

Mr. GEPHARDT. Yes.

Ambassador BROCK. My estimate last week for Joint Economic was that they could increase sales by 750,000 units on an annualized basis within 12 months. Now, that would represent 2.6 million, and let us assume that we have a 10 million car market; that is 26 percent.

Mr. GEPHARDT. Twenty-six percent. Do you think it could go higher after that?

Ambassador BROCK. Certainly.

Mr. GEPHARDT. Let me ask you about the Japanese market. A lot of the representatives of our industry have told me that they simply do not think the Japanese market is as open as our market is to them, assuming the VRA would come off, and they say that it is not tariffs, but it is nontariff barriers. They talk about inspection procedures and other problems. They also admit that they do not have a product yet that, frankly, is that attractive in Japan, but they hope to make one, Saturn being the obvious example.

Do you think it is wise for us to unilaterally take off this voluntary program if we do not get some substantial concrete steps to better open up the Japanese market? And, if we do not do that,

how do we argue to our American workers that this is a sensible thing to do?

Ambassador BROCK. First of all, I would make a modest demurral on the use of the word "unilateral." This action, if it is unilateral, is unilateral on the part of the Japanese, not on the part of the United States. We do not control that decision process. We certainly can make our views known.

But let us assume that we have that unilateral authority. I would argue that we should take them off because it is in our interest to do so regardless of what the Japanese do. If we have a problem with Japan, of market access, then we should use those tools that the Congress has given us—first, negotiation, and second, other action if the trade practices do burden our commerce—to try to get the market open.

But it is not, I do not think, logical to argue that the VRA—which many in Japan like and are very comfortable with—constitutes a significant form of leverage.

Mr. GEPHARDT. I understand what you are saying. I think the public perception is that we as a government are not tough enough in our negotiations with the Japanese and others, and that we have not achieved concrete results. And I am afraid that ending the VRA will be interpreted, whether rightly or wrongly, in the country among our constituents and the public that it is another example of our failure to get concrete improvement in their attitudes toward their own market.

Ambassador BROCK. I understand that, but I do believe that there are times when you have to say does it make sense for us to get somebody else by shooting ourselves through the foot.

If, in fact, these restraints are not of economic interest to the United States—if they, in fact, are doing us more harm than the Japanese—what possible logic is there for continuation?

Mr. GEPHARDT. A third question has to do with what other countries do. As you know, most other countries, industrialized countries, have much stricter quotas and constraints on incoming automobiles than we do. Italy holds them, I understand, to 2,200 cars; France, to 3 percent; Germany and Britain, to 10 or 11; and the European community as a whole to 7 percent; Australia and the more industrialized countries are comparable.

I know that we want to lead to open and free trade. We believe in that, and we have been the world leader. And I believe in that, as well.

The problem again is if we are the only one that is leading the way, it really makes it politically difficult in this country to argue to people—and this Government rests on the opinion of people, whether we like it or not—that this is a policy that makes sense. And how do we get other countries to follow our lead?

Ambassador BROCK. That has been a 200-year-old question, Congressman.

Mr. GEPHARDT. But one that we need to get answers to.

Ambassador BROCK. Well, it is, but let us ask the second question. If free trade—and we are not pure; we are certainly not totally free, by any characterization—but let us say that if it is a legitimate "Holy Grail" of long-term trade policy, if it is that beacon that you are seeking out there, and you ask the question "Why?" It

is because we have decided that free trade is in our economic interest, and it is good for this country, in its sum total of effects upon the American system and the opportunities of workers and consumers. Why, then, should we emulate the practices of others that are going to lead slower growth?

If you want to look at Europe—and that is a classic example—in the last 14 years, we have created 28 million jobs in the United States. In Europe, they have lost 500,000.

Now, I would argue that the fact that they have automobile restraints, restraints on electronics, and 15,000 other things is not of value to Europe, that they have not been advantaged by that, and maybe we have been doing something right.

Mr. GEPHARDT. I appreciate that, and I think there is value in being a leader, which we are—whether we want to be or not, from time to time. I think there is also value to us economically of allowing that competitive environment to exist.

I only say that our ability to continue that stance politically, in my humble opinion, depends on our ability to get other countries to more closely emulate our example. And there comes a point where that constituency leaves us, especially in a time when the underlying macroeconomic policy is hurting us as well, and really damaging our ability to be competitive, all of which you know, and all of which you understand better than I do.

I just urge that we begin to consider a policy of partial—I do not want to use the word "retaliation"—"toughness" is, I guess, the word I am searching for, as well as being a model, in order to get the response we have got to get from other countries.

Ambassador BROCK. Congressman, you are right, and I am in full accord with what you have said. If I could add one additional point, not only do we have to act outside the United States, aggressively and with toughness, but we also have to act internally to clean up our own house. And if I can make a pitch, the passage of the Gephardt/Bradley/Kemp/Roth/Regan/Baker legislation, or something close to it, would make an enormous contribution to that process.

Mr. GEPHARDT. You certainly are a good politician. [Laughter.]

Chairman GIBBONS. Particularly if we could rebate it at the border. If Mr. Frenzel will yield to me just a second here before I recognize him, let me say that these hearings had to get to the point of asking, "What do we do about the negotiations we have with the Japanese right now?" I do not have any inside information. I just have a hunch, from having watched these things for years, that this is what is going to happen. We, together with the Japanese, are orchestrating a lot of noise right now. We are trying to get them to do better in other areas, to open up their markets in other areas. At the same time, their voluntary restraints are coming to an end. And I guess, if I were in their shoes I would say, I hope the President of the United States will ask us to extend those voluntary restraints, because then it gives us the perfect excuse for saying no to all the other industries that are seeking admission to the Japanese market.

They can then say, "Well, we gave you the voluntary restraints on automobiles, and we have given you the restraints on steel, and we have bowed to you on textiles. You cannot really ask us to do all these other things. How much more can we do?"

That is why I hope that the President will say to the Japanese, "You have profited by the restraints. We want access to your market. We are not interested in restraints."

That is what I think is going to happen—the Japanese will restrain their export regardless of what the U.S. Government says. I think the U.S. automobile industry is going to get the restraints that they want. I think the UAW is going to get the restraints that they want—because then the Japanese can say, "Well, you know, we have given you auto restraints, we have given you steel restraints, we have given you textile restraints. We are not going any further." And we will be in an embarrassing position to push them any further, or they will be in a good position to say, "No, we are not going to open up those other markets like you want us to."

That means that the telecommunications workers do not get an opportunity for a better job. That means that the pharmaceutical and medical people do not get opportunities for better jobs here in the United States, and that means that the lumber workers do not get a better opportunity for a job here in the United States, nor do workers in other industries.

Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

Thank you, Mr. Ambassador.

The chairman really is talking about a question that I wanted to ask you. The gentleman from Missouri wants us to get other countries to emulate our devotion, if it can be called that, to open markets so that they will open some of theirs. If we were to ask the Japanese to continue—or, rather, if we were to tell the Japanese that, in our opinion, it would be a good thing for them to continue their voluntary restraints, would that make it more difficult for you in your other market opening efforts with Japan—telecommunications, wood products, et cetera—would it make it more easy?

Ambassador BROCK. More difficult.

Mr. FRENZEL. And there is no question in your mind about that?

Ambassador BROCK. None at all. The Chairman is absolutely right.

Mr. FRENZEL. So, if we really want to promote liberalization, as Mr. Gephardt indicated we should, and Mr. Pease indicated we should, at least one of the important tools is not to try to advise the Japanese on how they should proceed on these restraints?

Ambassador BROCK. I think that is right.

Mr. FRENZEL. Can we get an idea of your totem pole of objectives with the Japanese? Your telecommunications are pretty high on the priority list?

Ambassador BROCK. It is the top priority at the moment, for a couple of reasons. First of all, it is an area in which the United States is a world leader. There is no question about our ability to compete in the field.

Second, not only are we cost competitive, quality competitive, and service competitive, but the Japanese are privatizing their NTT and have to submit for approval to the Diet their new ordinances to implement that legislation by the first of April. That means that we have a very short time frame in which to negotiate.

Mr. FRENZEL. One day.

Ambassador BROCK. One day.

Mr. FRENZEL. Well, between the expiration——

Ambassador BROCK. Well, if we waited that long. Obviously, we are negotiating now. But, yes, the timing—I was asked by someone in Japan if the United States had chosen the conjunction of dates, the expiration of the automobile agreement as of 1 April—or, the automobile action, not agreement, as of 1 April—and the action on the telecommunications on the same date, and I said no, those are dates chosen by the Japanese Government. The fact is that they do occur at the same time, and frankly, the actions of both Governments will have a great consequence for the trading system on that date.

Mr. FRENZEL. Well, I do not mean to pit American telecommunications against the American auto industry—I do not think we have to—but in your opinion, is it better U.S. policy to open markets or to close our own?

Ambassador BROCK. It is always better to open markets than to close our own. I can think of no exception to that rule.

Mr. FRENZEL. Well, Mr. Ambassador, I am delighted with your testimony and enjoyed every word of it. I believe it is time for us to stop shooting ourselves in the foot, and time, as my colleague agreed, to put a little more pressure on Japan rather than to put less, and I do not mean to single out Japan. All of our trading partners can and should expect the same kind of pressure.

I hope you redouble whatever you have, and I hope the administration does, in fact, allow these voluntary restraints to expire, if the Japanese wish them to, without offering any further advice, that they should continue to maintain them.

Ambassador BROCK. Thank you.

Mr. GUARINI. Would the gentleman yield for a moment?

Chairman GIBBONS. Yes. Mr. Guarini.

Mr. GUARINI. Mr. Ambassador, I agree with you, and I think everybody in this room agrees that we should seek to open up markets instead of close our own markets. There is no question about it.

But if we come to an intellectual conclusion based on a long track record, that it is a one-way street, that they treat us differently than we treat them, that there is no reciprocity, do you feel that we then should take retaliatory action under section 301, and then treat them as they treat us and have legislation that would put us on an equal playing field with them? Or, should we sit back and take what we have been taking for the last 20 years?

Ambassador BROCK. Congressman, the Congress of the United States has given us our instructions, and those instructions are that we should take action against the unfair practices of other countries, failing an extended and really dedicated effort at negotiation. I do not want to answer that question in the context of one country, but it does seem to me that we got a very clear message from the Congress in the Trade Act of 1984. You strengthened the USTR's authority, you strengthened the President's authority. You said that we are concerned about a number of new issues. You asked us in our GSP program to evaluate the trade practices of other governments. I take that as a very clear direction, and I think it is a wise direction, and we have to take some action.

Mr. GUARINI. Let me ask you, hypothetically and philosophically—nothing to do with Japan—if we are clear in our mind that a foreign nation who is a trading partner is not treating us fairly, would you think that it would be proper for us to prescribe the same kind of treatment for that trading partner?

Ambassador BROCK. It is possible. I am a little cautious about saying a categorical "yes" because there may be a more precise device that we can use, that might not be exactly what they have done to us, but one that would be sufficient to get their attention, that might not cost us so much as the first action would.

You have to look at the basic dilemma that I have mentioned to you before of trade policy, and that is that when you start talking about using 2 by 4's and getting even, you have to be very careful to go soft, and the remedy suggests that it does us more violence than it does the other party, and we have to be careful about that. And the range of options is somewhat narrowed. But you gave us in the 301 authority, for example, which you mentioned, an enormous variety of tools that we can use—tariff bills, nontariff bills, all types of steps can be taken, and very precisely targeted——

Mr. GUARINI. But it has not been used, and it is not being used. I do not think it has been used at all.

Ambassador BROCK. Not to any great degree, that is correct.

Mr. GUARINI. So therefore, we are not really utilizing the tools we have available for the problem that is currently before us today.

Ambassador BROCK. Well, I think it is true that over the last 30 years, we have been reluctant to take some of these steps, and probably remain so—in part because of the pain we inflict upon ourselves, but in part because we want to be very sure that it is not a counterproductive action, with regard to other countries and to our ability to move the system forward. But there is a time when we lose patience, and you say that we have done all that we know how to do, we have acted in eminent good faith for long enough, and at that point, then, you have to consider some other options.

Mr. GUARINI. Lastly——

Mr. FRENZEL. Would the gentleman yield on that point?

Mr. GUARINI. I yield.

Mr. FRENZEL. Is the Ambassador saying or implying that if we really want to play economic hardball in trade policy with a cement baseball, that we would be foolish to do it in automobiles if we hurt the trading partner we want to work with in some other field like, say, a high-tech field?

Ambassador BROCK. Yes, surely.

Mr. FRENZEL. Thank you very much.

Mr. GUARINI. Well, from a personal viewpoint, there are some countries that respect strength and respect power, and if we do not use equal economic force in those circumstances, we can be taken advantage of. I do not think our country could stand to have, as projected this year, a $150 billion trade deficit.

Ambassador BROCK. Well, Congressman, I agree with you. But I want to point out to you that, as I did last week with your colleagues on the Joint Economic Committee, if I had to put a ratio on the trade deficit of the amount of that deficit that is caused by our actions and the amount of that deficit that is caused by the actions of others, frankly, 75 percent—maybe 80 percent—of the trade defi-

cit is caused by the dollar, not by the barriers in every other country in the world.

So, when you ask me to deal aggressively, I do not mind that, and I appreciate the advice, and frankly, I am willing to take it in a number of instances, and I think you may have to see us follow that process with regard to some this year—I hope not, but we may have to. But we are still dealing at the margin of that problem. The fundamental essence of that problem is here at home, and we alone can deal with it, and trade actions will not cope with that element of it.

Chairman GIBBONS. Mr. Pease, do you have more questions?

Mr. PEASE. Yes, Mr. Chairman, just two additional questions.

Mr. Ambassador, affixed to your testimony are several charts with statistics about imports and exports and so on. You do not have a column there for exports of U.S. automobiles to Japan. Could you give us what those figures are?

Chairman GIBBONS. It is just an asterisk that would not amount to much.

Ambassador BROCK. 2,000.

Mr. PEASE. 2,000 cars we exported to Japan last year. That is compared to the 1.9 million cars we imported from Japan.

Mr. FRENZEL. Well, if you will yield, they are all driven by left-handed Japanese. [Laughter.]

Mr. PEASE. There must be some left-handed Japanese, anyhow.

Mr. FRENZEL. More than 2,000.

Mr. PEASE. More than 2,000, right.

Mr. Ambassador, as you know, we had a $37 billion trade deficit with Japan last year; $20 billion of that accounted for automobiles alone. If your estimates are correct and an absence of the VRA's will mean an additional, say, 750,000 cars, or so, coming into this country, that would be another roughly $8 billion in the trade deficit.

Is that roughly correct?

Ambassador BROCK. I would put it a little lower. I would say given the export price, it would probably be closer to five, but it is a lot of money.

Mr. PEASE. It is a lot of money in any event. Is there any possibility at all that our efforts to increase our exports to Japan and other areas could conceivably get up as high as $5 billion over the next few years?

Ambassador BROCK. Over the next few years, yes; over the first year, probably not.

Mr. PEASE. Probably not. So, essentially, what we are talking about is a very large balance-of-trade deficit with Japan, and one that is likely to grow in the next year or two as a result of the relaxation of the VRA's?

Ambassador BROCK. That is correct.

Mr. PEASE. My constituents, I must say, have a difficult time understanding that.

In your testimony, you say recent history has shown that the "market-opening gestures from Japan have only been forthcoming after public and then congressional clamor has been raised in the United States, and usually even then in form rather than in substance. We are committed to change this too familiar pattern."

How are you going to go about changing that pattern?

Ambassador BROCK. When President Reagan and Prime Minister Nakasone met in January in California, they agreed upon a somewhat different approach, called the market-oriented sector-specific approach. The acronym has certain negative connotations, but as I told the Japanese, we expect it to be more than moss growing on the dark side of a stone in a damp atmosphere.

It was an effort to pick four areas where there is clear comparative advantage for the United States, to devote very substantial resources to opening up the market, removing all barriers. And we have four teams led by people at the Under Secretary level from different departments, so it is a complete interagency process in the U.S. Government.

We have counterparts assigned in Japan, and those talks, in some fits and spurts, are going on. But the effort is to see if, in fact, by a major political effort on the part of the leaders of both countries and the commitment of the leaders of both countries, we can modify that situation substantially.

If it works, and we will know in a very short period of time—the first date is April 1; the last date cannot be more than 3 or 4 months off before we have an understanding of the consequence of this effort. Then we can move to other areas and try to expand the process.

But we have tried everything else; we are going to try this and see.

Mr. PEASE. Well, Mr. Ambassador, I wish you well. Frankly, I am not very optimistic about the outcome in terms of actual dollars of exports. As you know very well, we are a representative democracy and I must say my constituents simply cannot understand how the U.S. Government, their government, can tolerate a $37 billion trade deficit with the Japanese.

Despite your efforts, that trade deficit is going to increase over the next couple of years. Sooner or later, if the Japanese do not get the message and open up their markets in a way that produces results and not just rhetoric, there is going to be a reaction in this country and in this Congress that the Japanese are not going to like, and I suspect a lot of other people are not going to like either.

Ambassador BROCK. Congressman, I know that. I have communicated that fact to the Japanese. But in fairness, it would be hard to find anybody that was more fed up with the present situation than I am.

But I will tell you that it is dangerous for us to single out one country as if it were the sole problem. We have a $20 billion deficit with Canada, and I have not heard anybody suggesting that for Canada. With the exception of a very few areas—potatoes from Maine and lumber and a few others—but in most areas, Canada is very well and warmly regarded in this country. But on a per capita basis, our deficit with Canada is at least two or three times larger than it is with Japan.

Mr. PEASE. Is not the answer market access, though, for us?

Ambassador BROCK. The answer is not market access in Canada.

Mr. PEASE. We do not have the same restrictions going into Canada that we do in Japan.

Ambassador BROCK. We certainly do not, thank the Lord. That is our largest trading relationship.

Mr. PEASE. Thank you very much.

Chairman GIBBONS. Well, I think the gentleman from Ohio has put his finger on a lot of it. The way to reduce the animosity that obviously grows from these kinds of deficits is not by injuring yourself, but by getting the other person's market open.

Ambassador BROCK. Exactly.

Chairman GIBBONS. Well, Mr. Ambassador, I appreciate your coming here. You probably missed your lunch, and we have got to go vote.

We are going to take until 1:30 to get a quick sandwich. Mr. Crandall will be the first witness. Thank you very much.

[Recess.]

Chairman GIBBONS. The subcommittee will come to order.

Our first witness this afternoon is Mr. Robert W. Crandall, senior fellow at the Brookings Institution.

Just take your time, Mr. Crandall. We realize we scare people when we start on time. Any time you are ready, sir.

STATEMENT OF ROBERT W. CRANDALL, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. CRANDALL. Well, Mr. Chairman, excuse me for being late. It is a pleasure to appear before your subcommittee and talk about the automobile industry and the effects of the voluntary export arrangement with Japan.

My name is Robert Crandall and I am a senior fellow at the Brookings Institution, and I have a brief piece of testimony which I will submit for the record and which I will summarize even more briefly.

Chairman GIBBONS. All right, sir. We will put the entire statement into the record, along with Ambassador Brock's entire statement.

For all other witnesses who want to summarize, we will put their entire statements in the record.

Mr. CRANDALL. I will summarize it briefly so that you can get on to hearing from the automobile companies, who can tell you how they have been restored to competitiveness with the Japanese by the voluntary export arrangement. I think there are a number of facts which need to be clarified, and perhaps which only the companies can clarify.

My testimony, however, I think will focus on sort of the difference between the industry today and its state 4 years ago, what the costs of the quotas have been and what the benefits of the quotas have been—I refer to the VER's as quotas, a mere term of art—and perhaps to suggest what the appropriate course of public policy from my perspective is.

It is useful to remember that when these voluntary export arrangements were put in place by President Reagan in 1981, the industry had just completed losing about $4 billion in 1980.

We are now in 1985, 4 years later. The industry has just realized at least $10 billion in after-tax profits; slightly under $10 billion for

the big three, but when all the component companies and everyone else reports, there will be in excess of $10 billion.

Sales have rebounded rather well from the depths of 1980-82. Unit sales for the U.S. industry are up to about 8 million cars last year.

Chairman GIBBONS. Are these annual figures you are giving us?

Mr. CRANDALL. Yes; not model year figures, annual figures.

Employment is back by 150,000 to 170,000 workers above the trough in 1980 and 1981. It appears that the industry has been restored to some considerable health. Of course, the doubts which remain derive from the fact that it has been restored to this health by trade protection, by protection against free importation of Japanese cars.

There can be little doubt that the quotas themselves have benefited the employees, the stockholders, and the management of the auto companies. Presumably, their intent, however, was not simply to do that, but rather to take what is, after all, a very important industry in the United States and to restore it to competitiveness—competitiveness which it had lost during the seventies as the Japanese industry made remarkable strides in producing particularly the smaller subcompact and compact cars.

It was in the late seventies that we suddenly realized that the U.S. industry actually suffered from a productivity disadvantage vis-a-vis the Japanese. I am not sure to this day that we know how deep that disadvantage was, but it was thought that with a short period of protection, perhaps the U.S. industry could recast its production facilities, build new plants, retool its plants, in such a way as to improve its output per man-hour to be at least equivalent to that which is realized by the Japanese.

Of course, to some extent that may not be enough. It may be a pyrrhic victory to accomplish that because, today, total auto industry compensation in Japan is somewhere around $8 an hour, whereas in our industry it is around $20 an hour.

It would seem that if we are to be truly competitive, given the minimal transportation costs of bringing cars in from Japan, that we would have to achieve a productivity level substantially above that in Japan.

There is no doubt that productivity has increased substantially in the auto industry since the depths of 1980 and 1981. However, this revival, particularly since 1982, has to be taken in a longer context.

In a longer context, from the late seventies—particularly, say, from 1977—productivity growth in the industry has only averaged about 2 percent a year. Given that it was in the late seventies that we discovered that our productivity trailed the Japanese and that the Japanese have not been standing still, it is likely that we still suffer a productivity handicap.

One thing that you might ask the industry representatives who follow me here today is to give you some idea of how their individual facilities stack up against the Japanese. We do not have very good data on that. There are a few studies, but we do not have very specific data on how stamping plants, assembly plants, auto components plants compare in terms of employees per unit of output.

If the industry was to take this period of trade protection and to restore itself to competitiveness, it would have to do so through a substantial increase in investment. In fact, over the period of the quotas, real investment spending fell as compared with the 4 years preceding the quotas.

It fell from 1981 through 1982 and 1983, and then rebounded in 1984. In 1984, real investment spending, according to Department of Commerce estimates—and the final figures are not in for 1984, obviously; this is based on anticipations for the fourth quarter—was slightly above, maybe as much as 10 or 11 percent above, 1981 levels.

But over the entire period, the total investment spending in the industry was down by probably 6 or 7 percent in real terms.

Chairman GIBBONS. Why was that?

Mr. CRANDALL. Well, a number of reasons and, again, I am not sure I can give you the definitive answer and you might want to ask the companies who do the spending.

One reason obviously was that we went through a very deep recession in 1982. However, at least one of the companies, General Motors, did not seem to be terribly constrained in its ability to raise capital.

Perhaps during the early period of the quotas, Chrysler and Ford felt that balance sheet considerations made it difficult for them to obtain debt capital, and the timing was bad for obtaining equity capital to expand their facilities and to modernize their facilities.

The recession might have had something to do with it, but given that they were anticipating a period of temporary trade protection, if they were to use this period to improve their efficiency through a massive capital spending program, one might have expected them to maintain the spending levels of the late 1970's.

Another problem for the American industry is clearly the quality of the products they have been producing. The evidence we have on the reliability of U.S. cars shows a substantial deterioration throughout the 1970's relative to the Japanese quality.

Thus far, there is very little evidence of an improvement in quality. Of course, it takes a couple of years to determine how well models will hold up in the service of consumers, but thus far the evidence would seem to suggest there has not been a narrowing of this quality differential.

The evidence compiled by surveys of readers of Consumer Reports would suggest that this difference has not been narrowed, with the possible exception of the Ford Motor Co., which seems to have improved its product quality slightly relative to the Japanese.

But all three companies seem to show substantial inferior performance of their cars in relative repair frequencies compared to the Japanese. And this problem has been around ever since the early 1970's.

In fact, we do not have good evidence on this, but there seems to be, also, a continuing difference between Japanese cars and American cars on the quality of fit and finish. These are things which are more difficult to measure, but could be measured in a marketplace when there is open competition for consumers' custom.

What one must conclude, I think, at this juncture is that it is probably true that we have not yet restored this industry to com-

petitiveness, particularly for the small cars. Part of the problem undoubtedly derives from the exchange rate.

The dollar has appreciated against the yen; not as dramatically as it has against the European currencies, but nonetheless the dollar has appreciated by probably 20 percent, 22 percent, something like that, against the yen since the imposition of the quotas.

Now, what about the costs of the quotas? Well, there has been a proliferation of studies just recently of what the quotas have cost the American consumer. Earlier last year, I estimated that the effects were something of the order of a $1,000 increase in the price of Japanese cars and maybe as much as $400 on domestic cars.

Since that time, there have been some other studies. The most recent one by the Federal Trade Commission staff economists shows smaller numbers, but they are based only on the year 1981. Most other studies show that this differential has widened over time and that the effect of the quotas, with recovering demand in 1983-84—the effects of the quotas have been more binding, and therefore have raised prices more.

I think there is little doubt that the price of Japanese cars has been elevated by the quotas, and I think none of the companies following me today would dispute that. Those of us who live in large urban areas think that it is a lot more than $1,000, but apparently it is less in some of the more rural areas in the country.

The debate centers on what the effect of the quotas has been domestic car prices. It is logical that when an important source of competition—namely, the Japanese cars—is restrained by Government fiat, that this allows the domestic companies some latitude and it provides an incentive for them to raise their prices.

This is hardly surprising, nor does it suggest avaricious behavior. It simply is rational, profit-maximizing behavior. But some of the companies, in particular, Ford Motor Co., have argued that they have not used this period to raise prices, and in fact, they provide estimates of what has happened to the price of small cars because they assume that consumers who are restrained in their ability to buy Japanese cars by the reduced supply of them, and therefore their higher price, will only choose small cars. Consumers will not go from a Honda Accord or a Toyota Camry to a midsized car, but rather, will only be looking at small cars.

Ford has an analysis of what has happened to small cars. Their sample includes the Omni/Horizon, produced by Chrysler, the Chevette T-1000, produced by General Motors, the Rabbit, produced by Volkswagen, and the Escort/Lynx, produced by Ford.

I would argue that these are not cars which are at the present time in the vanguard of the new wave of American competition to the Japanese. The Escort would be the closest to it, being the most recently introduced. Clearly, the Chevette and the Rabbit are in decline, and clearly, they do not represent the optimal second choice to the consumer who finds that the Camry or the Celica or the Honda Accord has too high a pricetag on it.

In fact, my own analysis shows that the more recent introductions have shown substantial increases in prices relative to what they would have been priced for the same attributes prior to the quotas. And my own estimate, therefore, is that the price of domestic cars has risen as a result of the quotas, and while I would grant

you there is substantial potential error to the estimate of $400, I think it is a reasonable number. In my testimony, I put it another way. I point out that a Camry could be bought in Japan last year for around $6,000 and would sell for between $10,000 and $11,000 here. After the transportation costs and the few extra details added to meet our safety regulations, perhaps it would sell for $8,000 or $8,500 here if there were free and open competition.

If Japanese cars were to fall by $1,000 to $1,500 in price, I wonder if the American companies could hold the line on their prices. It seems to me that if there were an increase in the supply of Japanese cars because the voluntary restraints are dropped, that the American companies would simply have to consider offering incentives, rebates, and implicitly or explicitly, price reductions.

It also seems to me that the reason why at least two of the three companies are so concerned about abandoning the quotas must be, at least in part, that fear. If the quotas only increase the Japanese sales in this market by 600,000 or 700,000 cars, the net loss of sales to the American companies would be far less than that, because prices of the imported cars would be lower, and the overall market demand would be somewhat higher. Let us say that was around 400,000 to 500,000 cars. The marginal profit on those cars might be somewhere between $800 million to $1 billion. If the other cars, the remaining cars that the American companies are producing, the 8 million cars, were to fall $400 in price, that would be a loss of $3 billion of before-tax cash flow to the companies. It seems to me that the latter loss is likely to be of more serious concern than the loss of incremental market share in the next year or two.

Well, finally, let me just conclude by saying that I do not see a good case for continuing voluntary restraints in this industry. If this industry's problems derive from an inability to produce cars as efficiently as the Japanese, the only way to force that efficiency from our industry—and I think it can be forced from our industry—is through open competition. It will require specifically some moderation of wages; it will require some changes of work rules; it will probably require some greater attention to product quality and workmanship in the plant; it might require some acceleration of capital expenditures.

It seems to me none of those is likely to take place as rapidly behind the protective wall of a voluntary restraint as in the face of open and free competition.

I will stop there.

[The prepared statement follows:]

STATEMENT OF ROBERT W. CRANDALL, BROOKINGS INSTITUTION[1]

Mr. Chairman and members of the subcommittee, it is a pleasure to appear before you today to testify on the effects of the restrictions on Japanese automobile imports.

My testimony is based upon an article that was published in the The Brookings Review last summer. I shall summarize the findings of that article and offer a few new observations today.

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[1] The author is a Senior Fellow at the Brookings Institution. The views set forth here are solely those of the author and do not necessarily represent the opinions of the trustees, officers or other staff members of the Brookings Institution.

In 1984, the U.S. automobile industry recorded profits of about $10 billion after taxes. Ford and General Motors negotiated substantial increases in their workers' compensation packages. Employment in the industry rose to 850,000, or about 150,000 above its recession level. Management bonuses were large once again. All in all, it was a very good year for the industry.

Unfortunately, the above description omits the fact that the auto industry's performance was greatly enhanced by strict limits upon competition from the largest most dynamic automobile industry in the world—the Japanese industry. Import quotas on Japanese cars for 1984 were set at 1.85 million units, or about 18 percent of the U.S. market. Hundeds of thousands of potential buyers of Japanese cars were forced to seek a less preferred alternative—a U.S. produced car—and others were forced to pay more for their choice of U.S. car.

We are now about to complete the fourth year of protection for the U.S. industry from cars built by unsubsidized Japanese firms who sell in the U.S. at prices far above their home market prices. These fairly traded cars are excluded from the U.S. market because the U.S. companies lost their competitive edge during the 1970's. With rapidly-rising gasoline prices, inceasing regulatory burdens, and declining demand, the Big Three lost more than $4 billion in 1980. Four years later, regulatory costs are no longer rising, gasoline prices have been falling, automobile sales are rising, and profits are at least $14 billion per year higher. One might think that these facts alone would lead to a consensus that the case for protection has evaporated, but two of the major U.S. companies want this protection extended for a new reason—the high relative value of the dollar.

When the dollar declines against the yen, the economy may be in recession again. In short, the proponents of protection will always find an argument for continuing the quotas by citing some adverse change in the economic climate. Obviously, once an industry obtains government protection from its competitors, it does not willingly relinquish it. I would predict that Ford and Chrysler are likely to argue for the elimination of the quotas at about the same time as the steel or textile industries come before you to tell you that they no longer need import protection.

THE EFFECTS OF THE QUOTAS

The VRA's imposed by President Reagan have obviously benefited the stockholders, management, and workers of the automobile industry at the expense of all other Americans. But have they achieved any wider, social purpose? One might think that the VRA's were intended to give the U.S. industry time to reinvest in plant and equipment, to design new fuel-efficient cars, to improve the reliability of its products, to reduce production costs, and to improve the "fit and finish" of their products so that it might be competitive once again. Have any of these objectives been met? Has their achievement been facilitated by quotas?

It is very difficult to estimate the effects of the quotas on the competitiveness of the industry. The companies are likely to admit that they still have substantial cost disadvantages in small cars relative to the Japanese. Part of this is due to the high value of the dollar at this time, but part is also because of the U.S. auto industry's high wage rates and lower productivity. Productivity growth in the industry has soared since the 1982 recession, but it is up only about 2 percent per year since 1977. Wages have resumed their upward march once again because an industry flush with $10 billion in profits could hardly approach the UAW with a story of suffering and hardship in 1984.

There is little evidence that the quotas have encouraged a rush of new investment. Department of Commerce data show that industry investment was lower in real terms during the last four years than in the four years preceding it. This is the standard result of protection: investment declines when import quotas are erected for industries such as carbon steel, specialty steel, and textiles. Investment rebounded in 1984, but it was not appreciably above 1981 levels.

Product quality may have improved for the U.S. automakers, but it is difficult to measure quality. Quality is in the eyes of the beholder or, in the case, the car buyer. If we let U.S. car buyers decide freely between Japanese and U.S. cars, we might have a measure of whether the U.S. companies have closed the quality or fit and finish gap with their Japanese rivals. Certainly, there is little evidence of improvement in the repair ratings of the U.S. cars relative to Japanese models. A recent issue of Consumer Reports warns buyers against buying any new GM model before it has been on the market a few years, and this is four years after the imposition of quotas and six years after the Iranian revolution drove up the price of gasoline and the demand for Japanese imports. The average repair frequency of U.S. cars remains far above the level achieved by Japanese imports.

Productivity has improved, but it had to improve after the disastrous 1977-81 period when it fell by 5 percent. Given that U.S. companies pay their workers about two and a half times the total compensation offered a more productive Japanese worker, one might expect U.S. companies to be improving productivity rapidly. Even our newest plants may be far from state of the art in manning practices. A recent Japanese visitor told me of his visit to a large, new assembly plant in the Detroit area. He was favorably impressed by its facilities, but he offered the opinion that the plant cost about twice as much to build as a comparable Toyota facility in Japan and operating the plant required at least twice as much labor.

In short, it seems unlikely that the U.S. companies have used the quota period to narrow their cost and quality gap with the Japanese. But that is not surprising. Narrowing this differential will take a major change in work practices and wage rates—an effort not likely to be undertaken nor to be successful if tried when an industry is basking in $10 billion of yearly profits.

At the very least, this committee should ask the industry for data on productivity levels and unit labor costs compared to those in Japan. And it might ask for estimates of repair frequencies for cars built before and after the imposition of the quotas. It is only with such precise data that we might determine whether the restriction on Japanese competition in the U.S. has propelled the U.S. companies towards renewed competitiveness.

THE COST OF THE QUOTAS

I have estimated that the quotas have raised U.S. car prices by about $400 per car through the 1984 model year. The recent rise of the dollar would probably raise that estimate considerably. In addition, the price of Japanese cars has probably been increased by at least $1,000 by the quotas. At 1984 sales levels, this translates into an increase in consumer costs of about $5 billion, with almost $2 billion going to Japanese companies and their dealers.

The Ford Motor Company argues that I have greatly overestimated the price effect on domestic cars. Ford admits that Japanese import prices have risen substantially, but claims that the U.S. companies have held small car prices down despite the rise in price of the competing Japanese models. Just how it explains this irrational behavior to their stockholders is not clear to me, but perhaps it has nothing really to explain. Car prices have risen substantially since the imposition of the quotas. The new models have been increased sharply in price relative to the models of similar size and performance that they replace. The small cars that Ford refers to in its analysis of prices are only the Chevette, the Rabbit, the Omni/Horizon, and the Escort. All of these cars were introduced before the quotas, and several are soon to be replaced. The consumer who finds that a dashing new Toyota Supra or Nissan 300ZX is too expensive because of the quotas might look at a number of U.S. models as substitutes, but I doubt that the Chevette, the Rabbit, or the Omni/Horizon would be on his list.

Last year, a resident of Japan could buy a Toyota Camry for about $6,000. This car would need a little additional equipment to meet our safety standards, but clearly it could be fitted with this equipment, shipped to the U.S., sold for $8,000, and still return Toyota a handsome profit. At present, this car sells for between $10,000 and $11,000 in the U.S., but some dealers may be getting even more for it. If the VRA's were abolished and Toyota were to offer the Camry at $8,000 in the U.S., I wonder if Ford could meet its sales objectives if it kept prices of the Tempo/Topaz or Escort/Lynx where they are? Given that the Corolla and the Sentra would also fall sharply in price, would Ford be able to sell many of its smaller cars without sizable reductions in price? Or, to put it another way, have the quotas not raised Ford's prices?

THE POLICY CHOICE

At this juncture, the VRA's are simply an embarrassment to an administration that professes to believe in free markets, (not in markets controlled and manipulated by governments) and an unnecessary burden on the public. If the auto industry, its suppliers, and workers are able to succeed in having the VRA's extended while the industry is basking in $10 billion of profits and paying its workers large premiums over the average industrial wage, how will the administration or the Congress be able to resist the cries for protection from far more troubled industries? Your calendar will be full of hearings on proposed quotas for industrial machinery, farm machinery, office equipment, tires, shoes, and even kitchen utensils and woodwind mouthpieces. The procession of industries with a justifiable case for protection after this precedent would truly be endless.

If the administration cannot force this industry to meet the Japanese competition head on in 1985, when will it be able to do so? Next year, we may be slipping into recession. The following year, one of the companies may be facing difficulties caused by poor product planning, low quality, or simply bad luck. After several more years of quotas, this industry will need continued protection just to survive the lethargic practices induced by years of being protected from competition. The only way to restore its competitiveness is to ask it to compete.

Chairman GIBBONS. I assume, then, if you were advising the President, you would tell him, "Mr. President, it is not in the best interest of America that these voluntary restraints be extended." Is that correct?

Mr. CRANDALL. Certainly, that would be my advice, and I think it hurts us more than it does the Japanese. If we were to accept the argument that it has not raised U.S. prices at all, the transfer from consumers, which has been largely the Japanese car companies and their dealers, of close to $2 billion a year, with much smaller transfers to U.S. companies.

Chairman GIBBONS. Last year, I read your analysis, which produced the startling figure that the restraints had cost nearly $1,400 per job per year—what was the exact figure?

Mr. CRANDALL. I forget what I had—it was about $5 billion divided by——

Chairman GIBBONS. Was it $160,000 per job?

Mr. CRANDALL. Yes, it was about $160,000, right.

Chairman GIBBONS. Now, I understand that figure—$160,000—is the cost to the American consumer to save one job in the American automobile industry for 1 year; is that right?

Mr. CRANDALL. That is the calculation of what it costs consumers in terms of transfers to increase employment directly in the auto industry. What is not in that is the increase in employment in other associated industries—you could reduce it by 50 percent if you just included that—but nor is there any estimated effect upon other industries, including exporting industries. As we reduce our supply of dollars overseas, we obviously have an effect on the value of the dollar, and make it more difficult for our exporting industries to export. And so therefore, there are employment effects in those industries, as well.

Chairman GIBBONS. Well, do you still stick by the figure?

Mr. CRANDALL. Well, yes, as a measure of the direct costs within the auto industry. I think it is very difficult to do these things for the overall economy.

Chairman GIBBONS. I understand. You have read all the criticism, I assume, and heard most of the criticism about your figures. Do you rebut those?

Mr. CRANDALL. Well, I do not know which criticism you are referring to. The principal one which was, for instance, even in the Post this week, has to do with the effect on prices. It seems to me that it is very unlikely that if you drop these restraints that U.S. car prices will stay precisely where they are. It seems likely that they will fall, and therefore, one may deduce that they have had an effect on prices.

The numbers of 200,000 jobs which one hears, I do not know where those numbers come from, since the swing from the depths of the lowest point of the recession to the present has been much less than 200,000 in the entire auto industry.

Chairman GIBBONS. Other people have made estimates, CBO and others, about the cost per job per year. There were some variations among them. Have you looked at any of those estimates, and could you comment on them?

Mr. CRANDALL. Well, one of the difficulties here is trying to figure out what the effect has been on market share. It depends very much upon your assumption there. In fact, the calculations done by the Federal Trade Commission, because they were only done for 1981, show a relatively small effect on market share and therefore a small effect on prices.

More recent numbers, or a study which has more recent numbers in it, the International Trade Commission study, it shows bigger numbers because it it focusing on the entire period of quotas. All of them involve—as does my own, by the way—all of these studies involve rather rough-and-ready estimates of what the shift of market share has been between the Japanese and the American companies, and that is very critical to the analysis.

Chairman GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Thank you, Mr. Chairman.

Thank you, Mr. Crandall. Is automobiles a specialty of yours?

Mr. CRANDALL. I spend some time on that, and on the steel industry, and communications industry, so I have my share of both the growing and the declining industries.

Mr. FRENZEL. OK. I would like to go over your statement about what happens to the extra money that the consumers spend. In your testimony, you indicate that if the figure is $5 billion, which seems to me to be as good as the next person's figure, nearly $2 billion of it goes to the Japanese under your assumption—or, the Japanese and their dealers and suppliers.

Mr. CRANDALL. Right.

Mr. FRENZEL. Because the prices of Japanese cars have gone up more steeply than American cars. Then, we have aided the Japanese carmakers more by our voluntary restraints than we have aided American carmakers.

Mr. CRANDALL. Yes, particularly the large ones, who had a large share of their quota.

Mr. FRENZEL. That is, I think, a proper way to evaluate it. It is disconcerting to read it. On page 4 of your testimony, you get into the investment situation. This morning, Ambassador Brock told us that the automobile industry has done wonderful things and invested $40 billion in refurbishing plants, or in new plants and equipment. Your testimony indicates quite a contrary point of view, saying that actually, investment in real dollars is not increased during the 4-year period of the quotas.

Do you want to comment on that?

Mr. CRANDALL. Well, the difference is narrower than it appears, Mr. Frenzel.

The reason is that during the period going into the quotas, the industry was already investing large amounts by historical standards. Obviously, they had a big job to do to retool for the changed market demands of cars in the United States, and for the increasing demands for quality and fit and finish.

As a result, in the period 4 years prior to the quota that I referred to, they were already investing substantially more than they had been back in the early seventies or late sixties.

But it is true that investment spending over the next 4 years was to fall.

When you start hearing numbers, $40 billion, $80 billion, over some period of time, you have to remember two things. One, this is a very big industry, and second, it takes a lot of investment in special tools, dies, jigs, and fixtures to produce specific models of cars. They are always spending a lot of money on that. The numbers always look big.

Mr. FRENZEL. And so, from your experience, although you did not cover it in your testimony, was the investment in that period high, low, average, or what?

Mr. CRANDALL. The investment even during the quota period was higher in real terms than it had been back in the late sixties and early seventies, but was down from what it was the 4 years prior to the quotas, yes.

Mr. FRENZEL. Those are not exactly the periods we are trying to emulate, though.

Mr. CRANDALL. Well, hopefully not. Those were simpler times, when cars could sell a little more easily in the United States.

Mr. FRENZEL. Other agencies, I think, have given higher estimates than yours. We have heard of some lower ones. Do you consider your estimate to be about midpoint, or are you on the high side?

Mr. CRANDALL. Estimates of what?

Mr. FRENZEL. Of the cost to the consumer.

Mr. CRANDALL. I have not tried to strike an average. I guess——

Mr. FRENZEL. I assume you have read the literature——

Mr. CRANDALL. Yes, right. I think that for the period I am talking about, my estimate is about average, among the sort of academic-type studies.

Mr. FRENZEL. Are the wages in the automobile industry still 50 percent over the average wage in manufacturing?

Mr. CRANDALL. They are more than that, and they are headed back up again.

Mr. FRENZEL. Is that where some of the money went from the extra load we put on the consumer?

Mr. CRANDALL. Well, yes, obviously, as Chrysler was being led through its bankruptcy proceeding, and General Motors and Ford were going through their own difficulties in the recession of 1982, there were wage reductions, which brought the premium down from the high sixties level down toward perhaps just under 60 percent premium over the average manufacturing wage. But it was very difficult in mid-1984 for Ford and General Motors to go out to the United Autoworkers and plead hardship when they were earning those very high real profits, and as a result, they had to give back a substantial amount of what they had won back in 1982—unless they were willing to take a long strike.

Mr. FRENZEL. So, Mr. Gibbons and my $10-an-hour constituents had to pay $5 billion more for automobiles so that those employees could restore wages received and more in 1984?

Mr. CRANDALL. That is right, and I think the contract appears to guarantee a real wage increase at a time when most workers in the manufacturing sector are suffering real wage declines right now.

Mr. FRENZEL. Thank you very much.

Chairman GIBBONS. Mr. Pease?

Mr. PEASE. Thank you, Mr. Chairman.

Mr Crandall, obviously, it has been a little easier for American automobile companies to sell Omnis and Escorts and so on over the last 4 years, because the Japanese have tended to go to the higher end of the market.

Do you think without voluntary restraints that it is possible for American companies to compete in the small car market?

Mr. CRANDALL. I do not know that I have a definite answer for you. I think that there is a good chance, yes, that we can. I do not think that we can at current wage rates or current work practices. I see that Mazda is coming over here and have negotiated, according to a recent report in the trade press, a substantially lower wage rate, about $6 an hour lower than their American counterparts here, and much less restrictive work rules. It seems to me that if they are forced to compete in this market, workers will have to reexamine their commitment to these work rules, which make them less productive than the Japanese counterparts, and may have to take a reduction in real wages, yes.

Mr. PEASE. I know you are not in a position to know for sure, but what is your judgment of the response of American automobile companies' top management? Would they decide to try to meet this competition, seek negotiations to alter work rules and so on, or would they just abandon the small car market?

Mr. CRANDALL. Well, you can ask the people that follow me here, but I think the largest company has indicated that it wants to follow a diversified strategy. On the one hand, it is launching a major new division to produce subcompact cars; on the other hand, it is in a joint venture with Toyota; and it also is willing to bring in cars from abroad. I guess it will turn on how efficiently they can make their American operations work and what happens to exchange rates. I think they are both very important.

Mr. PEASE. Isn't it reasonable to assume, or to guess, that over the next 4 years, if these VRA's are taken off, that American companies will produce fewer and fewer small cars in the United States?

Mr. CRANDALL. I think that depends to a large extent, again, on exchange rates and the price of gasoline. I think they will certainly be interested in looking at Korea and increasing their imports from Japan. We will have to see what that does to labor relations in the United States and to the efficiency of U.S. plants.

Mr. PEASE. It seems apparent to me that the dollar is strong and will remain strong over the next several years—certainly, if it is tied into Federal deficits, because Federal deficits are not going to be eliminated over the next few years.

Do you think it is fair enough to ask the auto companies to face this bonus we give to every imported car, year after year after year?

Mr. CRANDALL. Do I think it is fair to ask them to do what? I am sorry?

Mr. PEASE. To face the bonus that the strong dollar gives to every imported car, year after year after year.

Mr. CRANDALL. Well, unfortunately, that is not just true for the automobile industry; it is true for every industry in the U.S. economy that faces either export competition or import competition—export market or import market competition.

I do not think that in the long run, we are likely to thrive as an industrial society by responding to that through trade protection for all these industries—unless you are telling me that it is only the large industries who have a lot of political clout in Washington that are going to be able to get the protection and will make the rest of them compete.

Mr. PEASE. What does it say for the future of our society when you talk about the big three or big four U.S. companies being able to compete in the small car area, which is a fairly significant portion of the market, only if the workers are willing to make concessions on work rules, take lower wages?

That strategy is likely to be only partially successful——

Mr. CRANDALL. I think that is part of the strategy. I mean, everybody has to take the competition more seriously. It is not just on the backs of the workers. They have a tremendous industrial relations problem, obviously, having given these large wage increases in the past. You can read Mr. Iacocca's book, and he will tell you why they gave them. It is because, he said, he was unwilling to take a reduction in his bonus short term, and therefore, was unable to go along with bargaining very aggressively, and perhaps taking a strike.

Having given in year after year after year and allowing their wages to rise tremendously relative to the average industrial wage, they now have a problem.

Mr. PEASE. What happens when we lose these $40,000-a-year jobs, and the workers, if they are lucky, get jobs paying $4 an hour? What effect is that going to have on our society in terms of ability of workers to buy homes, purchase recreational vehicles, and boats, and that sort of thing?

Mr. CRANDALL. Well, I doubt that is a scenario we are going to face. If, in fact, $4 per hour is the next best alternative for most people risking unemployment in the automobile industry, it seems to me that they might settle for slightly lower wages than the $20 per hour in total compensation that they are getting at the auto plants.

Most studies of displaced workers in automobiles and steel do not suggest that, in fact, the wages fall that far.

Mr. PEASE. Well, I guess my concern is that the management and the UAW will have a difficult time agreeing on cuts in wages, and as a result, the plants will fail, or the management will just get out of the small car market, and then close down the plants, and these workers will be out of a job, and at that point, they have to look for alternative employment. For example, in the electronics industry, a few people are making a lot of money and most of the workers are making $4 an hour.

There is a basic shift in our society in terms of the kinds of people we are going to have in the marketplace trying to buy homes or cars or boats or anything else.

Mr. CRANDALL. I do not share your concern that we are gravitating toward a society where we pay the average worker $4 an hour.

Mr. PEASE. You do or do not?

Mr. CRANDALL. I do not, not at all. Our strength is the human capital of our work force and that human capital will command a rent far in excess of $4 an hour.

Mr. PEASE. Why would that be if there is free and unbridled competition with human capital elsewhere in the world willing to work for $4 a day?

Mr. CRANDALL. Because there is not the amount of human capital. There may be ergs of manpower, but there is not human capital of the sort we have. You can take examples from other industries. Our steel industry allowed its wage compensation to get up to as high as $24, $25 an hour, and what happened was the demand shifted away from them increasingly to small U.S. steel companies who pay $17 an hour, but get about twice to three times the productivity out of their workers.

It is not necessarily true that workers must be both unproductive and obtain a high wage through trade protection. There are other opportunities and there are other options.

Mr. PEASE. Not necessarily true, but not necessarily untrue either.

Mr. CRANDALL. I should also remind you that you are going to face declining employment in the automobile industry no matter what happens. It is unlikely that the growth in demand for automobiles can be as great as the necessary increase in productivity.

In all of these industries, we are facing declining employment trends. I think the issue for you, obviously, is to allow that to happen slowly and gradually rather than suddenly and disruptively.

Mr. PEASE. Sure. Well, this is maybe of historical interest, but not much else. What would have been your position 4 years ago? Do you think the VRA's were a mistake from the beginning?

Mr. CRANDALL. Yes; I do. I think that those of us who look at the effects of trade protection on other industries are never very happy with its results. I heard Australia mentioned earlier today as one of those many countries which prohibits automobile imports and has domestic content requirements.

The automobile industry in Australia has evolved to a position of being so uncompetitive that there is no way they can open it up to competition now. The consumers of Australia have to pay about 80 to 100 percent more for a car than consumers in Japan. That does not seem to me to be a way to protect one's standard of living.

Mr. PEASE. Thank you, Mr. Chairman.

Chairman GIBBONS. I have not read Mr. Iacocca's book, but I may run into him this weekend, and I thought I might discuss it with him. Did he really say that in his book?

Mr. CRANDALL. He says that, among a lot of other things that have made the major national newspapers and magazines, yes.

Chairman GIBBONS. I am going to have to ask my staff to find that quote in his book. That will be interesting.

I am for free trade because I think it raises the standard of living of all Americans. When we put on restraints as we have in the automobile industry, it is obvious that it has improved the

standard of living or preserved the standard of living of some people in the auto industry.

What has it done to the rest of American industry, this kind of restraint?

Mr. CRANDALL. The restraints in other industries, you are referring to now?

Chairman GIBBONS. Well, I am asking whether this restraint has had an impact on other American workers and on other American industries?

Mr. CRANDALL. Well, to the extent that it has had an adverse effect on the dollar—that is, by reducing our import demand, it has driven up the price of the dollar even further—surely, it has had an impact on other import-competing and exporting industries.

Given the behavior of the dollar, however, an economist is reluctant to offer definitive theories as to what is driving it.

Chairman GIBBONS. Well, we thank you for the light you have cast on this subject. Thank you very much.

Mr. CRANDALL. Thank you, Mr. Chairman.

Chairman GIBBONS. Next, we will hear from the Ford Motor Co. representative, Mr. Kenneth Whipple. He is accompanied by David McCammon.

Mr. Whipple, Mr. McCammon, welcome. You may proceed as you wish. If you summarize, we will put your entire statement in the record.

STATEMENT OF KENNETH WHIPPLE, VICE PRESIDENT FOR CORPORATE STRATEGY, AND DAVID M. McCAMMON, VICE PRESIDENT-CONTROLLER, FORD MOTOR CO.

Mr. MCCAMMON. Mr. Chairman, I am going to lead off. I am Dave McCammon, vice president and controller of Ford. And Ken Whipple, who is vice president of corporate strategy, will give the second part of our statement.

Chairman GIBBONS. All right.

Mr. MCCAMMON. I am going to deal with what has actually happened under export restraints, then Mr. Whipple will cover the rest of our statement on why auto export restraints should continue.

Mr. Chairman, our testimony will address the questions that are usually asked about this subject. First, has restraint worked? Yes, it is working. As the economy and car demand recover, restraint is helping ensure that most of the increase in production, sales and jobs benefit American workers rather than Japanese workers, putting 100,000 Americans back on the job last year alone.

During the first 2 years, of course, restraint had little or no impact because of the severe downturn in car demand that accompanied the recession. In fact, the Japanese market share continued to rise until early 1983.

These additional jobs and productions have contributed to U.S. economic recovery. They have raised the national income by $4 billion, which generated more than $1 billion in added tax revenue in 1984 alone.

Restraint also has provided the incentive for Japanese producers to invest in this market, something they had not done before.

Nearly $2 billion has been committed to the U.S. assembly of Japanese cars and trucks. That is not proportional to their sales increase here, but it is clearly the result of restraint and it has created more U.S. jobs.

Restraints also help keep the U.S. trade deficit from swelling even further, and it is keeping the bilateral deficit with Japan from reaching even greater crisis proportions.

Second, have U.S. producers used the restraint period effectively? Yes; the facts speak for themselves. Between 1980 and 1984 when total earnings amounted to only $1.5 billion, Ford invested $23 billion on new products and facilities and research and development.

In 1984, our capital and research and development investment was a record $5.4 billion. In 1985, spending will reach even higher levels. We have made real, measurable progress in the basics—quality, productivity and cost.

Our product quality, as measured by independent buyer surveys, has improved 55 percent in the last 4 years. This progress has dramatically narrowed the gap with the Japanese and put Ford quality in first place among major U.S. producers.

Ford's productivity gains, as measured by the number of hours required to produce a vehicle, have averaged 8 percent a year. This is well above the average rate of improvement for U.S. manufacturing in general, and the productivity gap with Japan has been substantially reduced.

Including these productivity improvements, Ford has cut annual operating costs by $4.5 billion. Without these actions, we would have had no profits at all last year.

Third, what is the impact of restraint on U.S. consumers? It is simply not true that restraint has inflated the prices of U.S. cars. Prices for all U.S. small cars which compete directly with Japanese imports have risen only 2.2 percent a year, or half the rate of inflation.

In Ford's case, sticker prices on our high-volume Escort models are actually lower today than they were 3 years ago.

Prices of Japanese cars have been inflated to some extent in the past 2 years, particularly dealer margins, as would be expected with the restriction of supply. Since restraint began, however, increases in Japanese list prices have been about in line with European cars which are not restrained.

So where do the exaggerated claims of price increases come from? Well, some critics, such as Robert Crandall, have confused price increases with shifts in consumer demand. As gasoline prices declined and the economy strengthened, Americans have been spending more to buy larger and better-equipped cars. But this change in consumer preference had nothing to do with restraint, and it makes no sense to treat the effect as a price increase.

Theoretical models, such as the one used in the recent International Trade Commission report, add to the confusion about car prices. Ford asked Professor Saul Hymans, a leading expert in quantitative economics, to look at the ITC study. His commentary, which we would be pleased to submit for the record, concludes that the incorrect use by the ITC of an econometric model led to results that are internally inconsistent. Further, he points out that realistic assumptions would imply that no change at all occurred in U.S.

car prices as a result of restraint. Professor Hymans also pointed to the economic benefits that are commensurate in value to any direct cost to consumers of higher prices of Japanese cars.

These questions of assumptions and methodology that inevitably arise from the use of models lead us back to looking at what actually did happen with respect to car prices. Fortunately, there are readily available data. The Bureau of Labor Statistics tracks the car price in calculating the CPI, so it is easy to determine the relationship between cars and all goods and services. The BLS data show that new car prices, including imports, have risen about 4 percent annually since early 1981, one point below the CPI for all items. This does not leave much room for big, overall price increases attributable to restraint or any other factor.

Mr. WHIPPLE. Turning to the future for a minute and why restraints should continue, one question that has been raised is whether the industry is now healthy enough to compete unassisted.

We have made great strides in improving our competitiveness, and we are committed to eliminating the cost gap with Japan. The problem is, the gains we have made so far have been swamped by the dramatic misalignment of the yen against the dollar.

For example, specific productivity improvements that we have made have reduced the relative cost of producing an Escort by $500. This improvement was more than offset when the yen/dollar relationship moved from about 200 to the dollar in early 1981 to 260 today. Today's relationship is some 30 percent worse than when the restraint began.

Currency distortions are not just a problem for autos, of course. They penalize the international competitiveness of all U.S. manufacturers, basic industries and high tech sectors alike. Last year, the U.S. trade deficit with Japan in electronics was almost as large as the deficit in auto trade.

Automobile production is unique, however, in the extent of involvement by governments around the world.

As we heard this morning, every major overseas market limits the import of Japanese cars. On another front here in the United States, Government fuel economy requirements enacted when gasoline prices were expected to be double today's levels effectively restrict sales of larger U.S. cars where we do have a comparative advantage in this country.

Next, how much longer is restraint needed? As you put it, Mr. Chairman, if not now, when? Ford is willing to compete head-to-head with the Japanese even before we have completely closed the productivity gap, but currency relationships hand our foreign competitors an unearned windfall subsidy of $1,000 a car. Restraints should not be ended without some real progress on the factors causing this exchange rate misalignment.

Next, what happens if restraint does end? We have heard a lot of numbers today, but shipments of Japanese cars are sure to increase. Production of U.S. cars will decline and American jobs will be lost. The only question is how much.

Japan has the capacity to produce 2 million more cars and no place else to ship them. A month ago, Mr. Nikaido, vice president of the ruling Liberal Democratic Party, said Japanese shipments would increase by 650,000 cars in the first year. Japanese officials

then upped the ante to 750,000 cars when they recently talked with Ambassador Brock. On this side of the Pacific, the Commerce Department forecasts 1 million extra Japanese cars within a couple of years.

The actual decline in U.S. production that would follow the increase in Japanese shipments of such magnitude could exceed any of these estimates when the secondary sales effect of fuel economy regulation are considered.

With overall car demand projected by most analysts to be flat, an added influx of Japanese cars will come at the expense of U.S. small car sales. Any loss in small car volume will reduce our corporate average fuel economy, or the so-called CAFE, which in turn would force us to restrict production of our larger family cars in order to comply with the fuel economy requirements.

A U.S. production decline of a million units combined, therefore, would mean a loss of as many as 200,000 U.S. jobs.

Finally, would the country be better off or not without restraint? Some consumers would gain because dealer markups on the Japanese cars would be lower as the supply increased. But other American consumers would face some restrictions in choice and some higher prices on larger cars, which already have felt the influence of fuel economy regulations.

Further, the decline in U.S. car production could cost the country $10 billion or more in factory output, and between $2 and $3 billion in tax revenue. In addition, the resulting increase in imports would send the trade deficit with Japan well on its way to the $50 billion mark.

In a well-functioning trade system, other sectors of our economy presumably would expand their exports to offset these economic losses. In the case of Japan, however, the bilateral trade deficit keeps on rising, despite 14 years of so-called market-opening measures by successive Japanese governments. It will take more than symbolic gestures to generate billions of dollars' worth of added U.S. export sales and to replace the jobs that surely will be lost if auto restraint ends.

Last week, Congressman Michel and Senator Danforth introduced resolutions calling for auto restraint to continue until U.S. access to Japanese markets improves and the bilateral trade deficit is reduced. We urge speedy adoption of those resolutions to put Congress clearly on record that it is time for the U.S. Government to draw the line with Japan on these escalating deficits.

In summary, without restraint, jobs and production will be lost and trade and budget deficits will worsen, without any certain offsets. With the trade deficit at $123 billion, the budget deficit approaching $200 billion, and a 30 percent problem with the dollar/yen relationship, this is no time to end auto restraints.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF KENNETH WHIPPLE, VICE PRESIDENT FOR CORPORATE STRATEGY, AND DAVID M. MCCAMMON, VICE PRESIDENT-CONTROLLER, FORD MOTOR CO.

Mr. Chairman, thank you for the opportunity to present our views on Japanese voluntary export restraint on cars. To be brief, our testimony will address the questions that usually are asked about this subject.

First, has restraint worked? Yes, it is working. As the economy and car demand recover, restraint is helping ensure that most of the increase in production, sales and jobs benefit American workers, rather than Japanese workers—putting 100,000 Americans back on the job last year alone. During the first two years, of course, restraint has little or no impact because of the severe downturn in car demand that accompanied the recession. In fact, the Japanese market share continued to rise until early 1983.

These additional jobs and production have contributed to U.S. economic recovery. They raised national income by $4 billion, which generated more than $1 billion in added tax revenue in 1984 alone.

Restraint also has provided the incentive for Japanese producers to invest in this market—something they had not done before. Nearly $2 billion has been committed to U.S. assembly of Japanese cars and trucks. That's not proportional to their sales here, but it is clearly the result of restraint and it has created more U.S. jobs.

Restraint also helped keep the U.S. trade deficit from swelling even further, and it is an important element in preventing the bilateral deficit with Japan from reaching crisis proportions.

Second, have U.S. producers used the restraint period effectively? Yes; the facts speak for themselves. Between 1980 and 1984, when total earnings amounted to only $1.5 billion, Ford invested $23 billion on new products and facilities and R&D. In 1984, our capital and R&D investment was a record $5.4 billion, and 1985 spending will reach even higher levels.

We have made real, measurable progress in the basics—quality, productivity, and cost. Our product quality, as measured by independent buyer surveys, has improved 55% in the last four years. This progress has dramatically narrowed the gap with the Japanese and put Ford quality in first place among major U.S. producers.

Ford productivity gains, as measured in the number of hours required to produce a vehicle, have averaged 8% a year. This is well above the average rate of improvement for U.S. manufacturing in general, and the productivity gap within Japan has been substantially reduced. Including these productivity improvements, Ford has cut annual operating costs by $4.5 billion; without these actions, we'd have had no profits at all last year.

Third, what about the impact of restraint on U.S. consumers? It is simply not true that restraint has inflated the prices of U.S. cars.

Prices for all U.S. small cars, which compete directly with Japanese imports, have risen only 2½% per year or half the rate of inflation.

In Ford's case, sticker prices on our high volume Escort models are actually lower today than they were three years ago.

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So where do exaggerated claims of price increases come from? Some critics have confused price increases with shifts in consumer demand. As gasoline prices declined and the economy strengthened, Americans have been spending more to buy larger and better-equipped cars. But this change in consumer preference had nothing to do with restraint, and it makes no sense to treat the effect as a price increase.

Theoretical models, such as the one used in the recent International Trade Commission (ITC) report, add to the confusion about car prices. Ford asked Professor Saul Hymans, a leading expert in quantitative economics, to look at the ITC study. His commentary, which we would be pleased to submit for the record, concludes that incorrect use by the ITC of an econometric model led to results that are internally inconsistent. Further, he points out that realistic assumptions would imply that no change at all occurred in U.S. car prices as a result of restraint. Professor Hymans also pointed to economic benefits that are commensurate in value to any direct costs to consumers of higher prices of Japanese cars.

These questions of assumptions and methodology—that inevitably arise from the use of models—lead us back to looking at what actually did happen with respect to car prices. Fortunately, there are readily available data. The Bureau of Labor Statistics (BLS) tracks new car prices in calculating the CPI, so it's easy to determine the relationship between cars and all goods and services. The BLS data show that new car prices, including imports, have risen about 4% annually since early 1981, one point below the CPI for all items. This doesn't leave much room for big overall price increases—attributable to restraint or any other factor.

Fourth, why should restraint continue; isn't the industry healthy enough to compete unassisted? We've made great strides in improving our competitiveness and are committed to eliminating the cost gap with Japan. The problem is, the gains we've

made so far have been swamped by the dramatic misalignment of the yen against the dollar.

For example, productivity improvements reduced the relative cost of producing an Escort by $500. This improvement was more than offset when the yen-dollar relationship moved from about 200Y/dollar in early 1981 to more than 260Y/dollar today. Today's relationship is some 30% worse than when restraint began.

Currency distortions are not just a problem for autos, of course. They penalize the international competitiveness of all U.S. manufacturers, basic industries and high-tech sectors alike. Last year, the U.S. trade deficit with Japan in electronics was almost as large as the deficit in auto trade.

Automobile production is unique, however, in the extent of involvement by governments around the world. For example, every major overseas market limits the import of Japanese cars. Here in the U.S., government fuel economy requirements—enacted when gasoline prices were expected to be double today's—effectively restrict sales of larger U.S. cars, where we have a comparative advantage over the Japanese.

Fifth, how much longer is restraint needed? Ford is willing to compete head-to-head with the Japanese even before completely closing the productivity gap, but currency relationships hand our foreign competitors an unearned windfall of $1000 a car. Restraint should not be ended without some real progress on the factors causing this exchange rate misalignment.

Sixth, what happens if restraint ends? Shipments of Japanese cars are sure to increase, production of U.S. cars will decline, and American jobs will be lost. The only question is how much.

Japan has capacity to produce two million more cars and nowhere else to ship them. A month ago, Mr. Nikaido, Vice President of the ruling Liberal Democratic Party, said Japanese shipments would increase by 650,000 cars in the first year. Japanese officials then upped the ante to 750,000 cars when they recently talked with Ambassador Brock. On this side of the Pacific, the Commerce Department forecasts one million extra Japanese cars within a couple of years.

The actual decline in U.S. production that would follow an increase in Japanese shipments of such magnitude could exceed any of these estimates when the secondary sales effects of fuel economy regulation are considered. With overall car demand projected by most analysts to be that, an added influx of Japanese cars will come at the expense of U.S. small car sales. Any loss in small car volume will reduce our corporate average fuel economy (CAFE), which in turn would force us to restrict production of our larger family cars in order to comply with fuel economy requirements. A U.S. production decline of a million units could mean a loss of as many as 200,000 U.S. jobs.

Finally, would the country be better off without restraint? Some consumers would gain because dealer markups on Japanese cars would decline as supply increased. But other American consumers would face some restrictions in choice and higher prices on larger cars, which already have felt the influence of fuel economy regulations.

Further, the decline in U.S. car production could cost the country $10 billion or more in factory output, and between $2 and $3 billion in tax revenue. In addition, the resulting increase in imports would send the trade deficit with Japan well on its way to the $50 billion mark.

In a well-functioning trade system, other sectors of our economy presumably would expand their exports to offset these economic losses. In the case of Japan, however, the bilateral trade deficit keeps in rising, despite 14 years of so-called market-opening measures by successive Japanese governments. It will take more than symbolic gestures to generate billions of dollars worth of added U.S. export sales, and to replace the jobs that surely will be lost if auto restraint ends.

Last week, Congressman Michel and Senator Danforth introduced resolutions calling for auto restraint to continue until U.S. access to Japanese markets improves and the bilateral trade deficit is reduced. We urge speedy adoption of these resolutions to put Congress clearly on record that it's time for the United States government to draw the line with Japan on these escalating deficits.

In summary, without restraint, jobs and production will be lost and trade and budget deficits will worsen—without any certain offsets. With the trade deficit at $123 billion, the budget deficit approaching $200 billion, and a 30% problem with the dollar/yen relationship, this is no time to end auto restraint.

Chairman GIBBONS. If Ford just worries about itself and does not have to worry about a lot of other things, how much longer will it

take before Ford can compete effectively without the voluntary restraints?

Mr. McCammon. We indicated in our testimony that we have made substantial progress during this period; namely, 55-percent improvement in quality and 35-percent improvement in productivity. We have narrowed the gap on both of those considerably.

As we indicated, also, if those were the only factors, we would be willing to compete now. Unfortunately, those are not the only factors. The major factor beyond our control is the yen/dollar relationship that adds a $1,000-a-car penalty; in effect, a subsidy for the Japanese to ship here.

With that staring us in the face, and with the huge trade deficit, it seems completely inappropriate to drop restraints at this time.

Chairman Gibbons. What yen/dollar relationship would it take to be competitive?

Mr. McCammon. The yen was at 200 yen per dollar prior to the restraints, and most economists believe, since the Japanese trade situation has done nothing but improve since that time and the U.S. trade situation has done nothing but deterioriate during that time, that a range of 180 to 200 would be appropriate.

Chairman Gibbons. You all do business in Japan; in fact, you are in partnership with some Japanese concerns. Is there any evidence that the Japanese are manipulating the yen?

Mr. McCammon. No. We have never suggested that they are manipulating the yen. In fact, today the greater problem is the dollar as compared with all currencies.

Chairman Gibbons. Well, what is Ford's suggestion for changing the yen/dollar relationship?

Mr. McCammon. We have to realize this is a different world than it was back in the early 1970's when we went to flexible exchange rates. Now, capital flows determine what exchange rates are. No longer is trade vital. If trade were vital, then we would have a much weaker currency and Japan would have a much stronger currency. Capital flows are overwhelming it.

We need new ideas, not old ideas, on how to improve the currency situation. The biggest help, of course, would be for the budget deficit to be reduced substantially, and therefore the interest rates to come down in the United States, and attract less foreign capital. This would help.

Mr. Whipple. That would affect the trade balance and the currency situation.

Chairman Gibbons. Mr. Frenzel?

Mr. Frenzel. Gentlemen, thank you for your testimony. I am a little surprised to hear you ask for the extension of the quotas. When will Ford be ready to compete in the international marketplace, do you expect?

Mr. Whipple. Well, as Dave just said, we are ready to say if you can solve the currency problem, you can cut us loose right now. That does not mean that we are on the Japanese in terms of costs. We still think that there is a total cost problem in the range of $2,000 to $2,500 per car.

We put currency, which is the biggest of the external things, along with the tax problem that some of the others have discussed, at about half that problem. The other half is clearly in our court,

and some of that is clearly not yet resolved and requires our going through a cycle. Let me give you an example of that.

In our business, it takes about 5 years to conceive and develop a new car. It takes longer if there is a new powertrain involved; it is about 6 to 7 years in that circumstance. So we are just now seeing products come on stream that have been designed with productivity in mind from the beginning.

We have cars coming out this fall, the Ford Taurus and the Mercury Sable, for example, that we have spent $3 billion to bring to market. Well, they are designed for a 40-percent improvement in assembly time. They should bring us, in the assembly component for those cars, virtually on the Japanese; not quite there because we are not building an all new plant to build them in, but virtually on the Japanese in terms of productivity.

We have to go through a number of cycles like that. Another example would be our Alpha Program and the GM Saturn Program. Those will not be in place until the end of the 1980's or the early 1990's. But I think the message that we are trying to send is we recognize what is our part of the ballgame and we are willing to take on that responsibility and say we will compete on that basis.

Mr. FRENZEL. The trouble for us is that you are one of the world's largest companies and one of the world's strongest companies. In 1984, you were one of the world's most profitable companies. You have been sustained under this voluntary restraint agreement for 4 years.

How much longer do the consumers of America have to bear this extra burden to get you into equilibrium, or wherever you want to be?

Mr. WHIPPLE. I think what we are trying to say is if the currency problem is resolved next Wednesday, then next Thursday you can take the restraints off.

Mr. FRENZEL. Well, do you think that the value of the dollar and the value of the yen are not set in various international marketplaces every minute of every hour?

Mr. WHIPPLE. I think they certainly are.

Mr. FRENZEL. Well, do you expect a sudden decline?

Mr. WHIPPLE. I do not expect a sudden decline, but I expect an eventual decline because I am optimistic about what the United States is going to do.

Mr. FRENZEL. I was trying to ask you, can you give me an estimate of when you expect to be ready?

Mr. WHIPPLE. I cannot tell you when the currency problem will be fixed, Mr. Frenzel.

Mr. FRENZEL. One of you complained about the fuel economy problems and the fact that the Japanese were going to sell smaller cars, you were going to lose markets, and therefore you were going to be knocked into a penalty condition.

You have come to ask us to lay a heavier cost burden on the consumers. Have you gone to the Congress and asked them to relieve you from the burdens of the auto efficiency requirements?

Mr. WHIPPLE. We are working right now on programs that would say if it is a case of clear market preference and we have essentially done the job, yes, we think those standards should be relaxed.

Mr. FRENZEL. Well, I am glad to hear that. I think they should be canned, too. They were built in another era against a different problem.

Mr. WHIPPLE. Well, it is not only us, Mr. Frenzel. An interesting thing to me is the fact that our least fuel-efficient car today gets better gas mileage than the most fuel-efficient car in 1975.

Mr. FRENZEL. I do not know if you heard the previous witness. Ambassador Brock said that the auto industry had invested lots of money, and that was a good thing, and was getting very productive.

A previous witness, Mr. Crandall, indicated that while there was an increase in investment, it was not all that wonderful on a historical basis in real dollars. What is the story at Ford?

Mr. MCCAMMON. Well, we think Mr. Crandall actually clarified it. He mentioned that the 1978-80 period was a very high level, and he was comparing against that level and he is right.

We did not wait for restraint to start going to fuel-efficient cars and going to front-wheel drive and changing our engines and transmissions. We were underway in the 1978-80 period, spending at very high levels.

We spent in the 1981-83 period, again, at high levels, only 10 percent less as an industry, on a real basis, than the prior 3 years. And if you include the last 2 years, 1984 and 1985, we spent as much.

The important thing is that we continued to spend at these very high levels despite the fact that we were losing money. I think what is remarkable is that we did this. We made that commitment as an industry to this country to spend at continuous record levels while we were having continuous, record losses.

Mr. FRENZEL. Is labor the largest component of your cost sheet?

Mr. MCCAMMON. And material costs, and that, of course, consists partly of labor of our suppliers.

Mr. FRENZEL. And what was the percentage of increase you granted in the most recent year under your contract?

Mr. MCCAMMON. Roughly equal to the CPI for wages.

Mr. FRENZEL. Do you agree with Mr. Crandall's statement that your employees are getting about 60 percent more than the average wage in manufacturing? Is that a fair statement?

Mr. MCCAMMON. In that range. That was the case in 1980. It has come down 10 percentage points in the last look. As a matter of fact, since 1980 our wages have gone up 13 percent through 1983 and the average manufacturing wage has gone up 24 percent. So we have narrowed the gap some.

We have a lot more work to do; we are fully aware of that, so is the UAW and our workers. And we are trying to work on that very important phase of our business.

Mr. FRENZEL. Do you accept to some extent his criticism of your work rules?

Mr. MCCAMMON. Well, we have to make major improvements there. In fact, as part of the last labor contract, we did make significant improvements in the work rules, and we have found the union far more cooperative in the last 4 or 5 years than previously. They are fully aware of the problems.

Mr. FRENZEL. Thank you very much, gentlemen. I think some day you have got to get in there and pitch, though. We do not want to keep you on crutches. We have got to get competitive.

Mr. MCCAMMON. We could not agree more and we are willing to take on our half of the action if we could just keep having some help on the other half.

Mr. FRENZEL. Thank you.

Chairman GIBBONS. Mr. Pease.

Mr. PEASE. Thank you, Mr. Chairman.

Thanks to both of you for your testimony. As a member who has not one, but two, large Ford assembly plants in his district, I am very much interested in the future health of Ford Motor Co.

I do appreciate your comments on the yen/dollar relationship and the part that that plays in your problems, and your willingness to accept the other competitive factors with the Japanese if only that yen/dollar relationship could be straightened out.

Presumably, if we could find a way to add a surcharge of some sort or other which would effectively bring the yen/dollar relationship down to about 200 to 1, you would be willing immediately to try to meet the Japanese on their own ground in terms of production costs and that sort of thing, is that correct?

Mr. MCCAMMON. Well, yes, it is because they have a 30-percent subsidy right now, and that is an advantage that nobody could overcome.

Mr. PEASE. Well, I think that is a point that really needs to be underscored. You are more than willing to deal with those things that are under your control, and you are willing, even though you are not quite at the point where you can compete head to head, to go anyhow until you get to that point.

But you cannot control something that is beyond your control, and I think it is unreasonable for us in the Congress to accuse you of seeking some kind of Government crutch when the chief problem you have is one that is of our creation, not your creation, and the solution is in our hands, not in your hands.

I mentioned this morning to Ambassador Brock that the Congressional Budget Office has just reestimated the President's budget proposals over the next several years, and he has proposed to us a budget that will create deficits in the $180 to $190 billion range for the rest of this decade. That does not seem to me to be likely to produce a better yen/dollar relationship and I do not see why we should penalize you for our inability to bring the Nation's fiscal picture into balance.

Well, let me ask you, your current smallest car is the Escort, is that right?

Mr. MCCAMMON. That is right.

Mr. WHIPPLE. In this country, that is right.

Mr. PEASE. And this Ford Taurus that is coming out this fall—what is the size of that in relationship to the Escort?

Mr. WHIPPLE. That is a family-size car. If you know the rest of our car line-up, it would be in the LTD-Marquis type of area, a family car.

Mr. PEASE. So your plans call for the Escort to continue to be your small car offering in the market?

Mr. McCammon. It was the best-selling car in America for the last 3 years.

Mr. Pease. Do you have on the drawing board or in scale models or that sort of thing, any other small car, as small as or smaller than the Escort?

Mr. Whipple. We are at the point now where we are putting together what the next replacement for the Escort is going to be.

Mr. Pease. And you say you are putting that together, and does that mean it would be 5 years before it comes out, given the normal timetable?

Mr. Whipple. We are in that stage right now.

Mr. Pease. What do you think would happen to sales of Escorts if the VRA is done away with?

Mr. Whipple. They would be lower.

Mr. Pease. Pardon me?

Mr. Whipple. They would certainly be lower.

Mr. Pease. Lower than they are now?

Mr. Whipple. Yes.

Mr. Pease. Would that drive your costs up for the Escort if your production is significantly lower?

Mr. Whipple. Yes, it would and, of course, there would be a period where we would be attempting as quickly as possible to take those costs out. But there would certainly be a period where our costs per Escort would be higher.

Mr. Pease. I am frequently approached, I guess, is a mild term, by constituents who look at the profits of Ford and GM and Chrysler and say if these profits are so high, why did you not reduce the stricker prices and try to follow old Henry Ford's dictum that you keep the price low and beat the competition by price, and produce more vehicles and make the profit that way.

Mr. McCammon. Well, we have. In fact, on the smaller cars, for example, the ones that compete with the Japanese, we indicated that on our Escort, the best selling car in America over this whole period of time, we have not raised the price; in fact, we have lowered it in the past 3 years. So we are doing exactly that on the smaller cars.

We have had a need for large car pricing partially to help us meet the CAFE law and try to shift the demand. We think this pricing story is greatly out of control.

Anybody that looks at the actual facts on pricing will find a great deal of restraint on the part of the industry in pricing, particularly on the cars that compete against the Japanese. And these theoretical models on what might have happened are just absolutely baloney.

Mr. Pease. You are saying that the sticker price on the Escort is lower now than it was 3 years ago?

Mr. McCammon. That is correct, Mr. Pease.

Mr. Pease. Does that also apply when you include the cost of the most popular options?

Mr. McCammon. Yes; in fact, I am talking about the most popular model and the most popular options on a comparably equipped basis.

Mr. Pease. Well, I think that is good information to have on the record. Thank you very much.

Mr. McCammon. You are absolutely right.

Mr. Pease. Thank you, Mr. Chairman.

Chairman Gibbons. Mr. Crane?

Mr. Crane. Thank you, Mr. Chairman, and thank you, gentlemen. You know, I was just reflecting back on sticker prices when I came here in 1969 I bought a VW just for commuting back and forth to work. I figured, you know, it is an $1,800 car. If it dies on me in 3 or 4 years and I drop it in the Potomac, I have still saved money over buying an expensive American-made car and losing $1,000 depreciation the moment I drive it off the lot.

But I was just reflecting. Your sticker price on an Escort today is under $6,000, is it not?

Mr. McCammon. That is correct.

Mr. Crane. So, actually, your Escort, in 1969 dollars, is priced the same as a VW was then?

Mr. McCammon. About that, right.

Mr. Crane. The dollar is worth 30-some-odd cents, low 30's, today's dollar against that dollar.

Mr. McCammon. It went up less than inflation, so that would be true.

Mr. Crane. Well, I think you folks have done a remarkable job in that respect—I mean the American auto companies have, and they have done it in the face of a lot of adversities, not the least of which have come out of this town with regard to regs imposed upon all manufacturing, but especially upon the auto industry.

I was just discussing with my colleague, Bill Frenzel, earlier that a good way to make a forward first step, assuming that these voluntary restraints end, is to end these fuel economy requirements on the auto manufacturers because no one, I think, in the world can compare with the auto industry in this country in the production of big cars.

I remember back 20-odd years ago when Detroit kind of poohpoohed, you know, these little, ugly Beetles coming into this country, and said, you know, Americans would never buy those funny little cars.

The fact is our metro systems throughout the entire United States are today, to me, an anachronism and I do not think they will ever pay for themselves because unlike when I was growing up when metro systems were profitable, everybody can afford to have more than one family car.

Sometimes it is two and sometimes it is three, and it is because of the incredible job, I think, the whole industry worldwide has done in producing an economical little vehicle that even kids can go out and buy in our affluent world.

For all of that, one of the things that has troubled me through the years is the disposition on the part of steel and autos in this country to make concessions to the unions on wages that were contributing to production costs in a day when I think the auto industry still held to that notion that they should ignore those funny little Beetles because they will never compete with us, not for an American market.

I think there was a tendency to make concessions on wages because of that assumption that we had no place to go, and finally it caught up with the American auto industry. And I was looking at

these disparities between the hourly wages in manufacturing as a whole in the United States versus the auto industry, and contrasting those with Japan.

Now, admittedly, they pay a premium for auto workers in Japan, too, it is higher than the average hourly wages in all manufacturing. But if you look at the ratios in 1983, for example, the hourly wages in the auto industry in the United States are two-and-a-half times greater than the hourly wage average in Japan in the auto industry.

But if you contrast all manufacturing, the ratio is 2 to 1 in our favor; we pay twice as much on an hourly wage basis. The fact of the matter is, if you go back to 1975, in the auto industry there has been a contraction of the ratios between the two countries.

And, in fact, in all manufacturing, people outside of the auto industry in Japan are improving their condition vis-a-vis people in manufacturing as a whole in this country.

I think the auto industry, because of the contraction of the economy, is in a position where it can drive some harder bargains, recognizing that you cannot pass all those costs on. But we can make a positive contribution here, it seems to me, by taking anachronistic legislation off the books, such as my colleague, Mr. Frenzel, mentioned.

Those fuel economy standards were all predicated on false assumptions, anyway, that we were running out of fossil fuels when the U.S. Geological Survey in 1975 said at those levels of consumption, we had a potential supply of oil in this country that would meet our needs for 185 years, when some people are saying oil will be obsolete by the early 21st century, anyhow, with the exception of petrochemicals.

There are so many potential things in the works that it seems to me that we ought to reexamine what we have done to you in terms of air quality control standards and efficiency standards. And if you lose the voluntary restraint battle, we might be able to provide some offsetting compensation by eliminating for you some of the excessive regulatory burdens that we have put on, all of which hurt your competitive position, but all of which must ultimately be paid by the consumer, too.

So when our concern looking to protect the consumer by opening up greater competition, letting Japanese cars come back in here because of the cost of voluntary restraints to the consumer, our other actions that have outlived their usefulness and are also maintaining an ongoing contributing cost to consumers.

Frankly, I think, you know, on balance, you folks are all to be saluted. You have done an extraordinary job in Detroit through the years. We are proud of the auto industry, but on the other hand I personally feel that the time of voluntary restraints has really outlived its usefulness.

And maybe those of us who share my point of view, with your help and support, might be able to persuade some of our colleagues over there on the Commerce Committee, is it not, Mr. Chairman, who have not necessarily moved with alacrity, to try and help the industry in ways that are not going to hurt the environment and ways that are beneficial to consumers and ways that are going to

guarantee the survival of our unique and outstanding auto industry.

I thank you for your testimony.

Mr. McCAMMON. Thank you.

Chairman GIBBONS. I want to end your testimony with something that may make you happy. I think you probably are going to get your voluntary restraints. Now that I have given you the good news, I will have to give you the bad news.

I think you probably are going to get your restraints at the cost of all other American industries, farms and factories. The Japanese are going to say, oh, we give in to you to give your voluntary restraints; we will continue them. We want to be good world citizens.

And then when we come back and say, yes, we would like to sell some medical equipment, we would like to sell some electronic equipment, we would like to sell some manufactured equipment, we would like to sell some farm and factory produce in your country, they are going to say, well, how much do you expect us to absorb? We are doing what we can. We are giving you what you wanted on automobiles; we are giving you what you wanted on steel; we have given you what you wanted on textiles. Now, when does the end of this giving come for the Japanese people?

We are going to be hard-pressed, then, to have an argument. So you and the UAW are probably going to get your wish, but somebody else is going to pay—there is no free lunch, no free lunch.

Let me ask you a question. Does the tax system that the European Community have and the tax system that the Japanese have and the fact that under the GATT rules, these taxes are rebatable at the border—does that cause you to be in a disadvantageous-competitive position?

Mr. WHIPPLE. Yes, it does. It certainly promotes export industries at the expense, really, of domestic industries in each of those places.

Chairman GIBBONS. Have you tried to quantify that?

Mr. WHIPPLE. It is hard to get a good number on that. There is probably more disagreement among the economists than there is on the cost of the restraint program. Our number on the total tax situation would be in the $300 to $600 range. So when I mentioned that the currency is half the problem, that is $1,000 for the currency and $300 to $600 for taxes, in total.

Chairman GIBBONS. Thank you very much.

Mr. McCAMMON. Thank you.

Chairman GIBBONS. Let us go now to the next witness, Ms. Whitman, who is a vice president of General Motors.

Mr. PEASE [presiding]. Ms. Whitman, we are happy to have you here and you may proceed.

STATEMENT OF MARINA v.N. WHITMAN, PH.D., VICE PRESIDENT AND CHIEF ECONOMIST, GENERAL MOTORS CORP.

Ms. WHITMAN. Thank you, sir. I am Marina Whitman, vice president and chief economist of General Motors Corp., and I am pleased to have this opportunity to talk about our views on the voluntary export restraint program.

I, too, would like to submit my entire statement for the record.

Mr. PEASE. Without objection, that will be done.

Ms. WHITMAN. We believe the time has come for the government of Japan to end its voluntary export restraint program which has put quantitative limits on the number of motor vehicles exported to this country.

The discipline of more open worldwide competition will assure that American consumers have access to the best products at the best prices, and it will also encourage the advancement of American technological innovation and industrial modernization, which demonstrably does lead to continued growth and more domestic job opportunities.

The restraints were imposed as the United States was heading into the deepest and longest recession since the 1930's, which hit the auto industry and its workers and the communities and the regions heavily dependent on it especially hard.

GM has consistently opposed protectionism and, in keeping with this philosophy, we did not seek the Japanese restraints, although we did take the view that given the severity of the country's and the industry's distress, imposition of the restraints may have helped head off more damaging and more rigid protectionist legislation.

As you know, the auto industry suffered very heavily during that prolonged recession, and as some of the colleagues who preceded me pointed out, in 1980 all four of the domestic automobile manufacturers lost money. They lost a total of $4 billion.

As a result, many industry observers both inside and outside the business were not optimistic about the future of the domestic automobile industry. But we did not share this pessimism and we set about a dramatic sequence of programs to upgrade our factories, modernize and improve our products, and change our longstanding structure and approach to the business to meet today's challenges and get ready for business into the next century.

We have, in fact, invested since 1979 about $40 billion in new plants, tools, and equipment. We invested $6 billion in 1984 alone, and about 85 percent of that was in the United States. We have built new plants in five States, with another eight plants in the planning stage or under construction, and we have remodeled plants in eight other locations.

I think any characterization of this industry in terms of rust belt or smokestack relic simply fails to take into account the technological, managerial, and labor relations innovations that are going on in our industry. There is no industry that is more involved in computers and robotics.

We have joined with Japan's Fanuc in a joint venture to produce robots in the United States. In November 1984, Electronic Data Systems became a part of General Motors, and the corporation has become involved with several companies pioneering in machine intelligence, all of which will contribute to the design and production of automobiles on a competitive basis.

At the same time, we have restructured our organization so that our auto manufacturing functions now come under two main groups, bringing business decisions closer to the operating and product decisions and closer to the marketplace.

And then most recently we have announced formation of the Saturn Corp., which brings a new domestic name plate to GM for the first time since 1918, but much more importantly brings entirely new approaches to every aspect of our business.

Saturn, which has been underway for nearly 3 years, is the company's clean-sheet effort to produce small cars in the United States that are fully competitive in quality and value with imports. Our Saturn Corp., which is expected eventually to have assets of $5 billion, will build and operate its own new, highly integrated manufacturing and assembly complex. It will use new products and process technologies and will have a separate dealer franchise system and a separate labor contract, using concepts worked out jointly by a UAW-GM task force.

We are breaking new ground in our relations with our employees because we want them to participate in making the decisions that affect their jobs.

As all of these GM actions demonstrate, the automobile industry is worldwide in scope and intensely and increasingly competitive. There is wide agreement among independent analysts that, today, the Japanese have a landed cost advantage in the United States for their subcompacts of $1,500 to $2,000 that arises from a variety of differences, running from wage rates through production systems to the geographical proximity of suppliers and services.

These cost differences would exist even if exchange rates were at equilibrium levels, although they are increased even further at present by the current severe dollar/yen imbalance, and they must be dealt with by the industry through innovative programs like Saturn.

Obviously, in recent years the competition in our industry has also been affected by the voluntary export restraints. During the first years of the restraint program, there was little impact on the U.S. market because of the recession.

But as our economy came back, the restraints began to affect the customer. Unfortunately, there have been a number of reports recently that may give the impression that American consumers are being confronted by sharp price increases on all cars from all automakers as a result of the restraints.

Isolating and quantifying the effects of the restraints on car prices is a difficult exercise, at best, as the wide variation in estimates makes clear, and you have heard a lot of them here today.

Some points are clear, however. One is that since the restraints limit only the supply of Japanese cars to American buyers, the greatest price effects have to have been on those same Japanese cars, and all the evidence indicates that that has indeed been the case.

Any spillover effects on prices of other cars must logically have been greatest for the smaller cars that compete directly with Japanese imports. But U.S. Consumer Price Index data show that car prices overall have been increasing less than 4 percent a year since 1980—about two-thirds of the overall inflation rate in consumer goods and services. And small car prices have gone up less than that.

For example, average prices for GM small cars increased by less than 2 percent per year between April 1981 when the restraints

were imposed and February 1985. And, in fact, since their introduction in the spring of 1981, the base price of a majority of Chevy's current Cavalier models—and the Cavalier was the largest selling name plate in the United States last year—this base price has actually declined.

In general, we believe the overall effect on car prices has been less than some analysts have suggested. Nevertheless, for the reasons I stated at the outset, we also believe it is time to drop the restraints and begin competing in an open marketplace again. Now is the time to remove trade barriers, not build them.

No doubt, some will say GM wants free trade for reasons which serve our own interests. The corporation does have programs to bring in a number of very small, fuel-efficient, low-priced cars from Japan.

To put this in perspective, and to reassure anyone who thinks that this is a move away from our U.S. base, if we brought in all the cars we had in our plan this year, if there were no restraints, they would amount to around 4 percent of our car sales.

By comparison, Chrysler, even with the restraints, imported about 8½ percent of its cars in 1984. Moreover, for the longer term, GM, through Saturn, is committed to cost-competitive manufacture of a small car in the United States.

We believe our long-term interests are served by having the industry respond to the rigors of worldwide competition. Continuation of restraints would sap the competitive strength of domestic producers, and that is not a fate we want for GM.

In particular, the artificial life support of protection would diminish the flexibility of the industry to adapt to and meet, and then beat, the inevitable new competitive developments which have to be anticipated. America cannot long afford such rigidity.

Other observers from whom you will hear or have heard will undoubtedly emphasize certain other points. They may emphasize the trade deficit, which was around $125 billion for 1984, and suggest a variety of direct interventions to diminish the pressure this puts on U.S. firms and workers, which is indeed extremely severe.

There is no question that despite the strength of our economic recovery, despite all that the American auto industry has achieved in the way of increased investment and lower break-even points and new and improved products and processes and more effective organizational structures, there are still substantial problems.

The auto industry continues to be regulated heavily by the Federal Government. In one area, fuel economy regulation, elimination of the voluntary restraints could worsen the problems facing full-line American manufacturers. With the price of gasoline declining and the economy growing, consumers are increasing their purchases of family sized cars, and that is the end of the market in which American manufacturers traditionally have had a competitive edge.

The so-called CAFE standard could begin to handicap us in our efforts to meet customer demand for family sized, roomier vehicles. If the restraints end, increases in Japanese exports to the United States would probably be at the small car end of the market. This could put additional pressure on the CAFE of full-line American manufacturers.

We believe it is important that CAFE requirements are reviewed to ensure that the standards, which were set 10 years ago under vastly different circumstances, do not handicap American manufacturers in their efforts to meet the challenges from abroad.

More broadly, America's large budget and trade deficits threaten the balance and durability of U.S. economic expansion. As I have mentioned, the automobile industry is handicapped by a substantial cost disadvantage compared with the Japanese producers, which is exacerbated by the present dollar/yen imbalance.

Management, labor and suppliers are working hard and cooperatively on our industry's specific problems, but the monetary fiscal imbalance created by our huge budget deficit and the unsustainable reliance of some other large industrialized countries on export-based rather than domestic demand growth must be addressed as well by public policymakers here and abroad.

These problems are major contributors to the severe overvaluation of the dollar and the competitive handicaps that result for U.S.-based firms. In addition, actions by other nations to remove their own trade barriers to U.S. exports are essential.

It must be borne in mind that trade restraints and direct market interventions generally are not good solutions to currency, overall trade or competitive imbalances. At the macroeconomic level, they are likely to be both ineffective and to have cumulative costs, thwarting international commerce without curing the problems at which they are directed. And at the industry level they are likely, if they persist too long, to handicap the long-run competitiveness and stability of the very industries and firms which receive their immediate protection.

Only the ability to compete effectively in the global marketplace can ensure the long-term viability of American firms and the long-term job security of American workers.

The U.S. auto industry is now at a major crossroads. If this industry does not become competitive with foreign producers, we face a choice between a cumulative shrinkage of U.S.-based production and employment on the one hand or, on the other, attempted survival on the life support of protectionism, with its attendant costs and inefficiences, its risk of retaliation, and its ultimate ineffectiveness in the absence of improved competitiveness.

If the U.S. automotive industry continues to increase its competitiveness on a worldwide basis, U.S. production, as part of an increasingly efficient and competitive worldwide industry, will be able to provide the widest choices and best values to consumers.

And a competitive U.S. industry will provide well paid, more secure employment not only to its own employees, but to those of all the other industries dependent for their own health on ours, and in so doing will enhance the competitive and strategic strength of our Nation, which is what all of us, I think, here today want to see.

[The prepared statement follows:]

STATEMENT OF MARINA v.N. WHITMAN, VICE PRESIDENT AND CHIEF ECONOMIST, GENERAL MOTORS CORP.

I am Dr. Marina v.N. Whitman, vice president and chief economist for General Motors Corporation. I am pleased to have this opportunity to discuss our views on Japan's voluntary export restraint program.

My testimony will deal with General Motors' position on ending the restraints, recent actions to improve competitiveness and other problems affecting the American auto industry.

We believe the time has come for the Government of Japan to end its voluntary export restraint program, which has put quantitative limits on the number of motor vehicles exported to the United States. The discipline of more open, worldwide competition will assure that American consumers have access to the best products at the best prices. It will also encourage the advancement of American technological innovation and industrial modernization, which demonstrably does lead to continued growth and domestic job opportunities.

Thus, removal of the restraints will serve the interests of individual consumers and our nation's economy. Their removal is also in the interest of the American auto industry and those who work in it.

The restraints were imposed as the United States was heading into the deepest and longest recession since the 1930s, a downturn which hit the auto industry, its workers, and the communities and regions heavily dependent on it especially hard. GM has consistently opposed protectionism. For example, in 1980 Thomas A. Murphy, then Chairman of General Motors, emphasized our position that the automobile industry's and the country's immediate problems, which were severe, would not be solved by protectionism, which carried serious long-term dangers of its own.

In keeping with this philosophy, GM did not seek the Japanese restraints. However, the Corporation did take the view that, given the severity of the country's and the industry's distress, imposition of restraints may have helped head off more damaging and more rigid protectionist legislation.

The automobile industry suffered heavily during the recent prolonged recession. In 1980, all four domestic automobile manufacturers—GM, Ford, Chrysler and AMC—lost a total of $4 billion. Many industry observers inside and outside the business were not optimistic about the future of the domestic automobile industry. General Motors did not share this pessimism and set about a dramatic sequence of programs to upgrade our factories, modernize and improve our products, and to change our longstanding structure and approach to the business to meet today's challenges and to get ready for business into the next century here in the United States and worldwide.

Pursuant to these programs, the Corporation has invested since 1979 about $40 billion in new plants, tools and equipment. We invested $6 billion in 1984 alone, with about 85 percent of that investment in the United States. We built new plants in Oklahoma, Louisiana, Missouri, Michigan and Kentucky with another eight plants in the planning stage or under construction. We remodeled plants in eight other locations.

Even considering these investments, many critics continue to use terms like "rust belt" and "smokestack relic" to describe the auto industry. These characterizations ignore the technological, managerial and labor relations innovations taking place in the industry. There is no industry more involved in computers and robotics. GM has joined with Japan's Fanuc in a joint venture to produce robots in the U.S. In November 1984, Electronic Data Systems became a part of General Motors. And the Corporation has become involved with several companies pioneering in machine intelligence.

At the same time, we have restructured our organization. GM's auto manufacturing functions now come under two main groups, bringing business decisions closer to the operating level and product decisions closer to the marketplace. A third group has been set up for trucks. Each is now responsible for its product, including engineering, manufacturing, assembly and marketing, and each is accountable for its quality, performance, and profitability. Most recently, we announced formation of the Saturn Corporation which brings a new domestic nameplate to GM for the first time since 1918, but, much more importantly, brings entirely new approaches to every aspect of our business.

Saturn, underway for nearly three years, is the company's "clean sheet" effort to produce small cars in the United States that are fully competitive in quality and value with imports. Our Saturn Corporation, which is expected eventually to have assets of $5 billion, will build and operate its own new, highly-integrated manufacturing and assembly complex. It will use new product and process technologies and

will have to separate dealer franchise system and a separate labor contract, using concepts worked out by a joint GM-UAW task force. Nothing will be more important to its success than the continuing cooperative spirit of the UAW and its members who have been brought into the auto, plant and organizational planning of Saturn from the program's inception. We are breaking new ground in our relations with our employees; we want them to participate in making the decisions that affect their jobs.

As these GM actions demonstrate, the automobile industry is worldwide in scope and is intensely and increasingly competitive. Japan has recently been the world's low-cost producer of passenger cars. There is wide agreement among independent analysts that today the Japanese have a landed cost advantage in the U.S. for their subcompacts of $1,500 to $2,000 that arises from a variety of differences, running from wage rates through production systems to the geographical proximity of suppliers and services. These cost differences would exist even if exchange rates were at equalibrium levels, although they are increased even further at present by the current severe dollar/yen imbalance. And they must be dealt with by the industry through innovative programs like Saturn.

In recent years, the competition in our industry has obviously been affected by the voluntary export restraints as well. These were put in place in April of 1981 with the assurance they would probably last only a year or two and certainly not more than three. However, the fourth full year ends March 31, 1985, and voluntary restraints are still with us.

During the first years of these restraints there was little impact on the U.S. market—the recession took care of that. But as our economy came back, the restraints began to affect the customer. Unfortunately, there have been a number of reports recently that may give the impression that American consumers are being confronted by sharp price increases on all cars from all automakers as a result of the restraints. Isolating and quantifying the effect of the restraints on car prices is a difficult exercise at best, as the wide variation in estimates makes clear. Some points are clear, however. One is that since the restraints limit only the supply of Japanese cars to American buyers, the greatest price effects have to have been on those same Japanese cars. And all the evidence indicates that that has indeed been the case.

Any spillover effects on prices of other cars must logically have been greatest for the smaller cars that compete directly with Japanese imports. However, U.S. Consumer Price Index data show that car prices overall have been increasing less than 4 percent a year since 1980—roughly two-thirds of the inflation in all consumer goods and services. And small car prices have gone up less than that since 1980. For example, average prices for GM's small cars increased by less than 2 percent per year between April 1981 and February 1985. And, in fact, since their introduction in the Spring of 1981, the base price of a majority of Chevrolet's current Cavalier models has actually declined.

In general, we believe the overall effect on car prices has been less than some analysts have suggested. Nevertheless, for the reasons I stated at the outset, we also believe it is time to drop the restraints and begin competing in an open marketplace again. Now is the time to remove trade barriers—not build them.

No doubt, some will say GM wants "free trade" for reasons which serve our own interests. The Corporation does have programs to bring in a number of very small, very fuel-efficient, low-priced cars from Japan. To put this in perspective—and to reassure anyone who thinks this is a move away from our U.S. base—if we brought in all the cars we had in our plan this year, they would amount to around 4 percent of our car sales; by comparison, Chrysler imported about 8.5 percent of its cars in 1984. Moreover, for the longer term, GM, through Saturn, is committed to cost competitive manufacture of a small car in the U.S.

We believe our long-term interests are served by having the industry respond to the rigors of worldwide competition. Continuation of restraints would sap the competitive strength of domestic producers and that is not a fate we want for General Motors. In particular the artificial life-support of protection would diminish the flexibility of the industry to adapt to and meet, then beat, the inevitable new competitive developments which have to be anticipated. America cannot long afford such rigidity.

Other observers from whom you will hear will doubtlessly emphasize certain other points. They may emphasize that the trade deficit was around $125 billion for 1984 and suggest a variety of direct interventions to diminish the pressure this puts on U.S. firms and workers, which is indeed extremely severe.

Despite the strength of our economic recovery, and despite all the American auto industry has achieved in the past few years in the way of increased investment, low-

ered break-even points, new and improved products and processes and more effective organizational structures, neither the country nor the industry has emerged from the woods into full economic and competitive sunlight.

The auto industry continues to be regulated heavily by the Federal Government. In one area—fuel economy regulation—elimination of the voluntary export restraints could worsen the problems facing full-line American manufacturers. With the price of gasoline declining and the economy growing, consumers are increasing their purchases of family-size cars. This is the end of the market in which American manufacturers traditionally have had a competitive edge.

The current corporate average fuel economy standard (CAFE) could begin to handicap us in our efforts to meet customer demand for family-sized, roomier vehicles. If the restraints end, increases in Japanese exports to the U.S. would probably be at the small-car end of the market. This could put additional pressure on the CAFE of full-line American manufacturers. We believe it is important that CAFE requirements are reviewed to ensure that the standards, which were set ten years ago under vastly different circumstances, do not handicap American manufacturers in their efforts to meet the challenges from abroad.

More broadly, America's large budget and trade deficits threaten the balance and durability of U.S. economic expansion. As I have mentioned, the automobile industry is handicapped by a substantial cost disadvantage compared with Japanese producers—a disadvantage exacerbated by the persistent dollar/yen imbalance. Management, labor and suppliers are working hard and quite cooperatively on our industry's specific problems. However, the monetary-fiscal imbalance created by our huge budget deficit and the unsustainable reliance of some other large industrialized countries on export-based rather than domestic demand growth must be addressed as well by public policymakers here and abroad. These problems are major contributors to the severe overvaluation of the dollar and the competitive handicaps that result for U.S.-based firms. In addition, actions by other nations to remove their own barriers to U.S. exports are essential.

It must be borne in mind that trade restraints and direct market interventions generally are not a good solution to currency, overall trade, or competitive imbalances. At the macroeconomic level, they are likely to be both ineffective and to have cumulative costs, thwarting international commerce without curing the problems at which they are directed. And, at the industry level, they are likely, if they persist too long, to handicap the long-run competitiveness and stability of the very industries and firms which receive their immediate protection. Only the ability to compete effectively in the global marketplace can ensure the long-term viability of American firms and the long-term job security of American workers. Necessarily, therefore, U.S. auto producers must be both allowed and encouraged to carry on with their intensive efforts to do just that.

The U.S. auto industry is now at a major crossroad. If the U.S. automotive industry does not become competitive with foreign producers, we face a choice between a cumulative shrinkage of U.S.-based production and employment on the one hand or, on the other, attempted survival on the life-support system of protectionism, with its attendant costs and inefficiencies, its risk of retaliation, and its ultimate ineffectiveness in the absence of improved competitiveness. If the U.S. automotive industry continues to increase its competitiveness on a worldwide basis, U.S. production, as a part of an increasingly efficient and competitive worldwide industry, will be able to provide the widest choices and best values to consumers. And, a competitive U.S. automotive industry will provide well-paid, more secure employment—not only to its own employes, but to those of all other industries dependent for their own health on our industry—and, in so doing, will enhance the competitive and strategic strength of our nation.

Chairman GIBBONS. Dr. Whitman, I want to thank you for your statement and commend you and, through you, commend your company for its forward-looking attitude on this very difficult problem.

Ms. WHITMAN. Thank you, Mr. Chairman.

Chairman GIBBONS. I want you to know that I am a fellow who puts his money where his mouth is. I expect to take delivery of one of your cars next week.

Ms. WHITMAN. I am delighted to hear that. I know it will serve you well.

Chairman GIBBONS. I hope I am as delighted as you are.

What makes GM different from the other two companies in the American scene here?

Ms. WHITMAN. I think there is no question that we all want the same thing. We all want a healthy, competitive U.S. industry. What we disagree about is the best way to get there. It is our view that whatever immediate gains we might think we were getting from continued protection, they would be more than offset by the fact that that would tend to distract everybody involved and make it more difficult for us to get on with the most critical task, which is that of becoming globally competitive. We are disagreeing about means, not about ends.

Chairman GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Thank you, Mr. Chairman.

It is a pleasure to welcome an old friend of the committee's.

Chairman GIBBONS. Not an old friend, a friend of long standing.

Mr. FRENZEL. Yes, OK, a young friend whom we know and love.

Thank you for your testimony. I am delighted to see that one company in the industry at least believes that it must compete and that its industry must compete rather than endorse a policy which means a downward path for all Americans. I hope, at least, that some of your company's philosophy is based on that idea rather than a 50-percent share of the U.S. market and a pretty darned nice statement for 1984.

You indicate that you would like to get rid of the CAFE standards. Has your company communicated that to the Congress other than in your testimony today?

Ms. WHITMAN. Well, I simply said in my testimony, sir, that we do think that any review of those standards should take account of changed conditions. Now, as for exactly what position we would take—we still are examining all the options and trying to decide the best way to achieve that broad, overall goal.

But there is no question that conditions have changed very substantially since those standards were introduced, and the question of what the ending or nonending of the VRA's would do to our CAFE situation is dwarfed, of course, by what the effect is on our CAFE situation by what has happened to the prices of gasoline.

I think when the CAFE Program was introduced, there was projected for now about a $2.50 price per gallon. Instead, we have a dollar a gallon and, clearly, that makes a tremendous difference in the situation we face on CAFE.

Mr. FRENZEL. What do you, as an economist, think General Motors and other American companies are going to do long term with a labor rate that is, about 2½ times that in Japan?

Ms. WHITMAN. I think, sir, that there obviously is no short, simple answer to the question of our competitiveness, but the fact is that the labor rate is only one element in the much more complicated picture.

Certainly, there will have to be moderation in increases in compensation rates, but I think the most important string we have in our bow is working together to find ways to vastly increase the productivity, the efficiency and the effectiveness with which we go through the design and manufacturing and assembly process of automobiles.

I think that is where the main thrust of our competitive efforts will lie, although obviously, there also does have to be moderation on the cost-per-hour side.

Mr. FRENZEL. Do you believe that some of the Japanese investment in the United States was forced by the quota, or are those investments the result of long-term planning and the inevitability of the size of the market to the Japanese?

Ms. WHITMAN. It is always hard to try to single out particular factors that entered into a decision, particularly somebody else's decision. But let me say, of the two investments which are already in existence, the Nissan investment was originally for trucks and trucks are not covered by the voluntary restraint program.

And as I understand it, Honda has certainly acquired the land for that Marysville plant before the voluntary restraint program was introduced. So, while I would not attempt to read anybody's mind, I would think that more entered into those decisions than simply the restraint program.

Let me say, by the way, on the question of relative wage rates and what is how many times what, that obviously also depends very significantly on what the exchange rate is. I do not think we have any illusions that at a yen/dollar ratio of 260, which is what it is roughly, give or take a couple of points, today, we can make it.

There is going to have to be, obviously, some adjustment back toward more appropriate levels of the yen/dollar relationship as well. Clearly, that is imposing a major additional handicap.

Mr. FRENZEL. What is appropriate?

Ms. WHITMAN. Nobody knows that answer.

Mr. FRENZEL. Your predecessor witness said 200 would be a nice number. Do you remember that it has ever been 200?

Ms. WHITMAN. Yes. I believe it was actually at one point somewhere around 180.

Mr. FRENZEL. I can remember when it was 360.

Ms. WHITMAN. I also remember when it was 360; that is exactly right.

It is very hard to know exactly what the equilibrium rate is in terms of purchasing power relationships. There is very widespread agreement, I think, though, that it is very substantially less than it is today. And I would not get into an argument over whether it was 200 or 210, or some people would say 190.

Furthermore, I think whatever it is, it has tended over time to move in the direction—that is the equilibrium relationship has tended to move in the direction of the yen having higher value because, on the whole, their rate of inflation has been less than ours, whereas, in fact, the actual currency relationship has moved rapidly in the other direction. That does not seem to be a sustainable situation over the long term.

Mr. FRENZEL. Thank you. Who do you think has benefited most from the VRA, the American producers or the Japanese producers?

Ms. WHITMAN. I do not think there is any question that on a per-car basis, the major amount of benefits from the quotas have gone to the Japanese producers. And for all the wide variations you have in all the studies that have come out, the one thing they all seem to agree on, which logic also suggests, is that the biggest price

impact has been on Japanese cars. I do not know of any disagreement with that.

Mr. FRENZEL. Thanks very much for your testimony.

Chairman GIBBONS. Mr. Pease?

Mr. PEASE. Thank you very much, Mr. Chairman.

Ms. Whitman, we appreciate your testimony, and also appreciate the work that General Motors is doing on the Saturn project. I would remind you that we have a couple of very good sites in my district, if you want to carry that back to your search committee.

Ms. WHITMAN. I will certainly mention it.

Mr. PEASE. Currently, your small cars are the Chevette and, what, the X cars? What are the smallest cars in your line?

Ms. WHITMAN. Well, there is some disagreement about what a small car is, but in the subcompacts, we have the Chevettes and the Pontiac T-1000s, and in the compact range we have the X cars, and those are the largest ones. The question of what is small is——

Mr. PEASE. Sure.

Ms. WHITMAN. And then, of course, we have the Pontiac Fiero, which is a whole other sporty-type car.

Mr. PEASE. Sure. How much longer do you expect to be marketing the Chevette, for example?

Ms. WHITMAN. As long as the consumer wants it.

Mr. PEASE. Is that right?

Ms. WHITMAN. And I mean that quite seriously. We cannot predict, ever, how long the life cycle of a car is going to be. As long as the American consumer continues to want to buy the Chevette in reasonable numbers, we will continue to produce it.

Mr. PEASE. Is the same thing true for X cars?

Ms. WHITMAN. Well, of course, we do have a continuous cycle of replacements of cars as new models come in, and we have now said that the next cycle of cars is coming in which will replace the X cars, and so they will be phased out.

Mr. PEASE. Do you have in your plans a new American-built small car that will come into the showrooms prior to Saturn?

Ms. WHITMAN. No. The new American-built popular small car would be the Saturn.

Mr. PEASE. And what year do you expect that it will be in the showroom?

Ms. WHITMAN. We do not really know. Roger Smith has said he is bound and determined that he is going to drive one off the production line before he retires, which I believe is in 1990.

But beyond that, all I can say is that we are pushing just as hard as we can. But, you know, this is new in every aspect. There just is not any precedent for what we are doing with Saturn, so it is pretty hard to foresee exactly what the timetable will be.

Mr. PEASE. Well, I ask that question because as much as I admire the company for its all-out commitment to the Saturn project, I find it a little surprising that, knowing about the CAFE requirements, General Motors has not planned over the last 5 years to produce a new small car which would help it meet those CAFE requirements.

Ms. WHITMAN. We had such a plan; we did have a plan to produce—I believe it would have been a U.S. S car, and the fact is that we had to stop those plans when we realized that we could not

at that time, with the processes then available, produce a small car at a competitive price in the United States and not lose money on it.

And there is no way that we could, in good conscience, put a new car program in place in which we knew before we started that we were going to lose money.

Mr. PEASE. I have, as well as two Ford assembly plants, two excellent General Motors plants in my district and a United States Steel Corp. plant, and I am a little sensitive when a company like United States Steel Corp. accumulates a lot of cash and invests it outside of its primary area of production.

According to the Wall Street Journal, General Motors is pursuing "an ambitious acquisition strategy that has them looking at companies in electronics, defense, and financial services."

I presume that this ambitious acquisition strategy will not, in your opinion, detract from your ability to finance and pursue improvements in automobile production.

Ms. WHITMAN. On the contrary, if you look at the areas in which we have made major investments, all of them are complementary with our automotive business. Whether it is Electronic Data Systems, which is the country's largest computer service firm, which we expect to be central to the way Saturn operates and ultimately to the way all of GM operates, whether it is the machine intelligence companies we have bought or the robotics joint ventures we have entered into, or even the finance companies, all of these things are in some way synergistic with or related to our basic line of business.

So while, yes, there is diversification—and we do hope to get some spreading of our risk from that diversification—we are not setting out to be just some sort of mindless conglomerate. Everything is intended to fit together and make us more effective in our basic business.

Mr. PEASE. Thank you, Dr. Whitman. That is very reassuring.

Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you, Doctor, for coming today and I hope your flu gets better.

Ms. WHITMAN. Thank you very much, Mr. Chairman.

Chairman GIBBONS. Our next witness is Mr. R.S. Miller, executive vice president for finance and administration of the Chrysler Corp. He is accompanied by Mr. Robert A. Perkins, who is the vice president of the Washington office of Chrysler Corp.

Let me say before you sit down that I like your new little station wagon and I like your new little convertible. I commend you for that progress.

STATEMENT OF ROBERT S. MILLER, JR., EXECUTIVE VICE PRESIDENT, FINANCE AND ADMINISTRATION, CHRYSLER CORP., ACCOMPANIED BY ROBERT A. PERKINS, VICE PRESIDENT, WASHINGTON OFFICE

Mr. MILLER. Thank you very much for that compliment, Mr. Chairman.

I am Robert S. Miller, executive vice president for finance and administration at Chrysler, and with me is Robert A. Perkins, vice

president for our Washington office. If I might before I start, I sat in the back and listened to the testimony of Professor Crandall and was alarmed at his observations in general.

But in particular, he misquoted from a book from my chairman, the book "Iacocca," talking about taking big bonuses. Let me read the exact quote from the book.

> I began by reducing my salary to one dollar a year. Leadership means setting an example.
>
> I did not take a dollar a year to be martyr. I took it because I had to go in the pits. I took it so that when I went to Doug Fraser, the union president, I could look him in the eye and say, here is what I want from you guys as your share. And he could not come back to me and ask, you SOB, what sacrifice have you made.

Now, that is what my chairman said in his book, not what Mr. Crandall quoted. I would like to give you this copy of the book so you can read it perhaps in preparation to meeting him on Saturday, and I imagine he would be delighted to autograph it for you if you wish.

Chairman GIBBONS. Well, that is good. Thank you very much; I appreciate it.

Mr. MILLER. If I might go on, Mr. Chairman, 2 weeks ago Chrysler testified before the Subcommittee on Economic Stabilization of the House Banking Committee. We stated in no uncertain terms Chrysler's grave reservations about lifting or even loosening the restraints on Japanese cars in the face of a record trade deficit with Japan, the yen/dollar imbalance that makes Japanese products 30 percent cheaper than they should be in the United States, and a competitive situation so blatantly skewed that 750,000 American jobs could be lost when all is said and done.

Chrysler's stance all along has been that we believe our Government is not applying good poker sense in the area of international trade. We applaud the efforts of the Members of the Congress who have led the fight to do something to improve our trade situation, notably Senators Danforth and Boren and House Minority Leader Michel, who have presented their concurrent resolutions, and Chairman Dingell, who has introduced H.R. 1050.

We are baffled, frankly, by the administration's apparent willingness to give up a bargaining chip worth $5 billion this year alone, and perhaps double that in future years, while not so much as making a dent in Japan's trade barriers or moving one step closer toward realizing our Nation's goal of 10 to $12 billion in increased trade in value-added goods with Japan.

We are also baffled by some of the conclusions of the recent ITC study, which was prepared, we understand, under considerable time duress in order to be ready for this set of hearings. We feel the study has led to a great number of unfortunate distortions, especially due to its conclusions on auto pricing and employment effects under restraints. To be brief, in the area of pricing, we especially have problems with the fact that the study relies on a small theoretical price model based on historical data 10 to 24 years old, and that it treats as a price increase the shift in consumer preferences during the 4-year restraint period to bigger and more luxurious cars—a shift more attributable to falling gasoline prices and economic recovery.

With regard to employment, we think the study drastically underestimates the employment effect of moving the VRA by failing to count the direct jobs that will be lost by auto industry suppliers and the indirect jobs that will be lost in other industries due to the ripple effect.

We believe that the ITC study underestimates the potential job loss by at least 90 percent. Now, I have attached to my testimony, Mr. Chairman, an appendix which details a number, but not all, of Chrysler's strong disagreements with that ITC study.

Chairman GIBBONS. We will put the appendix and all materials in the record.

Mr. MILLER. Yes, sir; thank you.

[The prepared statement follows:]

STATEMENT OF ROBERT S. MILLER, JR., EXECUTIVE VICE PRESIDENT-FINANCE AND ADMINISTRATION, CHRYSLER CORP.

Thank you, Mr. Chairman. With me at the table is Robert A. Perkins, Vice President of Chrysler's Washington Office. I want to thank you and the members of the Subcommittee for giving me this opportunity to state Chrysler's position on the voluntary restraint agreement on Japanese cars and its impact on U.S. trade policy.

Mr. Chairman, about a week and a half ago, Mr. Perkins and another Chrysler official, Mr. Steffen, testified before the Subcommittee on Economic Stabilization of the House Banking Committee. They stated in no uncertain terms Chrysler's grave reservations about lifting—or even loosening—the restraints on Japanese cars in the face of a record trade deficit with Japan, a yen/dollar imbalance that makes Japanese products 30 percent cheaper and/or more profitable than they should be in the U.S., and a competitive situation so blatantly skewed that 750,000 American jobs could be lost when all is said and done.

Chrysler's stance all along has been that we believe our government is not applying good poker sense in the area of international trade, and we applaud the efforts of the members of the Congress who have led the fight to do something to improve our trade situation—notably Senators Danforth and Boren and House Minority Leader Michel, who have presented their concurrent resolutions; and Chairman Dingell, who has introduced HR 1050. We are baffled, frankly, by the Administration's apparent willingness to give up a bargaining chip worth $5 billion this year alone, and perhaps double that in succeeding years, while not so much as making a dent in Japan's trade barriers, or moving one step closer toward realizing our nation's goal of $10 to $12 billion in increased trade in value-added goods in Japan.

We are also baffled by some of the conclusions of the recent ITC study, which was prepared, we understand, under considerable time duress in order to be ready in time for this set of hearings. We feel this study has led to a great number of unfortunate distortions, especially due to its conclusions on auto pricing and employment effects under restraints.

In the area of pricing, we especially have problems with the fact that the study relies on a small, theoretical price model based on historical data 10 to 24 years old, and that it treats as a "price increase" the shift in consumer preferences during the four-year restraint period to bigger and more luxurious cars—a shift more attributable to falling gasoline prices and economic recovery.

In the area of employment, we think the study drastically underestimates the employment effect of removing the VRA by failing to count the direct jobs that will be lost by auto industry suppliers, and the indirect jobs that will be lost in other industries due to the "ripple" effect. We believe the ITC study underestimates the potential job loss by at least 90 pecent.

I have attached to my testimony, Mr. Chairman, an appendix which details a number, but certainly not all, of Chrysler's strong disagreements with the ITC study.

Now, as we all know, despite our strong protests and those from Cognress, the President's Cabinet Council on Commerce and Trade recently announced its unanimous opinion that the voluntary restraints should *not* be renewed beyond March 31st.

As far back as October 1983, Mr. Chairman, I believe Chrysler was the first to publicly identify what came to be known as General Motor's three-pronged "Far East strategy." We predicted then that GM hoped to accomplish three things of

major importance to this nation's trade and ecomomic policy: One, end voluntary restraints so that the company could import great numbers of small, low-cost Japanese and Korean cars, knock-down cars, and components; two, bend the antitrust laws with a joint venture with Toyota in California so that it could control small-car prices; and three, lobby to have the federal fuel economy standards dialed back so that the company could concentrate on selling high-profit bigger cars without penalty.

As we look around us today, we see just how prophetic we were. The CAFE standards for light trucks have already been dialed back, and it seems certain that very soon there will be a push to do the same on passenger cars. The GM-Toyota joint venture is underway, although Chrysler is still vigorously suing to stop it. And from all official government statements, it now appears certain that the voluntary restraints on Japanese cars will be dropped, freeing GM to import those great numbers of built-up cars from its Japanese partners, Isuzu and Suzuki, as well as from its Korean partner, Daewoo, In fact, just this month, Chevrolet's director of international marketing said that Chevy no longer plans to build subcompacts in the United States. Instead, he said—and I quote—"We are now in business to import Isuzus and Suzukis in perpetuity," unquote.

Mr. Chairman. I'm a member of the board of Directors at Chrysler, and also the companys' head of finance. Given those reponsibilities, I and others at Chrysler are bound to protect the interests of the company's owners and current employees by making financial decisions that are prudent given prevailing conditions, no matter how hard those decisions may sometimes be.

Up to this moment, Chrysler has been advocating a freeze for ourselves and other importers of Japanese vehicles at current levels. However, given the running rules dictated by GM and the administration, it is now clear that Chrysler will have to make the hard choice of adopting a parallel "Far East strategy" of its own. It's apparent to us that GM wants a lion's share of the auto trade deficit. Well, I'm here to say that Chrysler is forced to demand its share of the trade deficit, too. There is no secret in building products in undervalued yen or Korean won or whatever and selling them in overvalued dollars.

To that end, Mr. Chairman, in a matter of days, Chrysler will be confirming to its Japanese partner, Mitsubishi Motors Corporation, that we will require up to an additional 200,000 small Mitsubishi cars a year from Japan, in addition to the 87,500 per year we currently import. In other words, we are preparing to roughly triple our imports of built-up Japanese cars.

Chrysler has a strong, 15-year relationship with Mitsubishi. We already have port facilities, warranty agreements, and a parts and service network. And our entire dealer network is familiar with Mitsubishi's products, so in essence, all we have to do is turn up the spigot. The net result is that Chrysler will continue to be a strong, profitable company, although unfortunately more of the products we sell will be made in foreign countries by foreign workers.

Given the running rules laid out before us, we have little choice but to make this hard decision.

Thank you, Mr. Chairman. That concludes my testimony. Mr. Perkins and I will be happy to answer any questions.

APPENDIX

CHRYSLER CORPORATION'S SELECTED CRITICISMS OF ITC INVESTIGATION NO. 332-188, THE INTERNATIONALIZATION OF THE U.S. AUTOMOBILE INDUSTRY AND ITS EFFECTS ON THE U.S. AUTOMOBILE INDUSTRY

In Chrysler's opinion, the ITC study is a mixed bag, at best. It is 65 pages long, and about 60 of those pages contain hard, empirical, and sensible observations about the U.S. auto industry during the four years of voluntary restraints. The other five pages or so, however—the five pages that have gotten so much attention in the media—seem almost unrelated to the credible data in the other 60 pages. Those five pages contain estimates based, not on reality, but on outdated textbook theories, illogical reasoning and mistaken assumptions, and out-and-out ignorance of the auto business. Chrysler's criticisms of the study's findings center especially on the areas of auto pricing during the period of voluntary restraints on Japanese cars and employment effect of the restraints.

First, pricing. The ITC study asserts that the voluntary restraint agreement has cost the American consumer just under $16 billion in higher U.S. and Japanese car prices during the four years of restraints. To arrive at this figure, the ITC reportmakers theorized—reasonably, we believe—that the Japanese could have shipped

about 1 million more cars into the U.S. had there been no VRA. However, the ITC then applied a small and probably outdated theoretical price model to that assumption, one which said that for every one percent increase in Japanese car shipments into the U.S., the price of cars to consumers would drop by two percent. In its study, the ITC itself admits that this theoretical model, with its assumed price elasticity of minus 2, is quote, "arbitrary."

In addition to being arbitrary, the ITC model is outdated. It was taken from a 1978 study by Charles River Associates, and is based on historical data from 1960 through 1974. In other words, it is based on customer buying patterns and company pricing patterns from a period before the energy crisis of 1979, before the great onslaught of Japanese imports, before, the period of 20 percent interest rates and double-digit inflation, and before the great recession of 1980–82. It might as well have been from the Dark Ages as far as today's auto market is concerned.

A much more recent study on Japanese imports, released by Data Resources Incorporated in January 1985, assumes a price elasticity, not of minus 2, but of minus 3 in the compact segment and minus 5 in the subcompact segment—the two segments where the Japanese do 95 percent of their business in the U.S. This study may also be "arbitrary", but at least it is up to date; and just using its assumptions, rather than those of the River study, would have cut the ITC's estimates of Japanese car price increases under the VRA by more than half.

A second criticism of the ITC's pricing conclusions is that they completely ignore the shift in consumer preferences during the four-year restraint period from barebones economy cars to bigger and more luxurious models. Again, it appears as if the ITC study were written by two people with vastly different intentions. The text of the study acknowledges that there indeed was a significant mix shift to larger and more option-laden cars during this period, due in great part to falling gasoline prices and a recovering economy after 1982. To put it another way, people could now afford to buy, and were buying, steak instead of hamburger.

But while the text of the ITC study acknowledges this mix shift, the phenomenon is completely ignored in the theoretical price model. As a result, the conclusions of the ITC study assume that, for instance, one hundred percent of the difference between a stripped Omni and fully New Yorker is somehow a "price increase." That's like going to a supermarket and somehow being shocked that a pound of New York strip steak costs more than a pound of ground chuck, and then calling that difference a "price increase."

A price study more relevant to this issue would have been to compare the prices—car for car—of just compact and subcompact cars during the restraint period. Since the Japanese do nearly all of their American business in those two segments, that's where one would expect to find any "price gouging" under restraints. Yet Chrysler, for one, increased its prices in these two segments an average of just 1.3 percent a year during the four years of restraints, or about five percent in total, compared to a Consumer Price Index that rose 17 percent during that same period. That's hardly "gouging."

Chrysler's second major criticism of the ITC study is its conclusions on the employment issue. The study asserts that only 44,000 American jobs are at stake if the U.S. opens up the floodgates to subsidized Japanese imports. Sadly, that number is a drastic underestimation.

First of all, the ITC study limited its calculation of employment effects to only the employees of the GM, Ford, Chrysler, AMC, VW of America, and Honda of America. But jobs will be lost in other companies and other industries as well. By leaving out auto suppliers, for instance, the ITC study failed to account for even what is commonly considered the total direct employment effect. Since it is generally accepted that there are at least 2.3 auto supplier jobs for every auto company job, it can be assumed that the ITC study underestimated just the direct job-loss effect by at least two-thirds.

Moreover, the ITC study failed to account for the so-called "ripple" effect these auto jobs have on the economy. Although uncounted, these indirect, third-tier jobs are very real, too. Since it is also commonly understood that the "ripple" itself is almost twice the direct effect, by ignoring auto suppliers and the ripple effect, the ITC study has understimated the total employment impact of lifting voluntary restraints by about 90 percent.

Chrysler calculates that the job loss could be much higher than even that. Without restraints, and unless something is done about the yen/dollar currency problem, the Japanese could capture 45 percent of the U.S. auto market by 1990. A 45-percent market share represents additional sales of 3 million Japanese cars in America, and the loss of 750,000 American jobs.

Finally, the ITC study states that the reason its estimates of the employment impact were limited to just domestic OEMs is that it is likely that voluntary restraints actually helped increase the value of the dollar, and thus worsened the net trade and employment situations of other non-auto industries in the U.S. In other words, the study implied that voluntary restraints have allowed the auto industry to steal away jobs from other U.S. industries.

Such a conclusion shows just how mired in out-dated theory the ITC study is. Traditional textbook trade theory indeed says that the lower a country's trade deficit, the higher the value of its currency. Using this traditional theory, the ITC study therefore assumes that since voluntary restraints cut the U.S. trade deficit by about $4 billion over four years (which one would think is a good thing!), this cut must have caused the dollar to rise and, consequently, jobs in other U.S. industries (especically export industries) to be lost.

That's fine in theory. But in reality, massive capital flows into the United States in the last few years have so swamped trade flows that traditional textbook trade theory has been rendered all but meaningless. That's proven by the fact that in just four years the U.S. has gone from a net worldwide trade surplus to a record net trade deficit of $123 billion. Yet in that same period, the U.S. dollar, which should have fallen according to this theory, has risen to unprecedented heights, due in large part to the massive flows of foreign capital from all over the world into the U.S. in recent years.

In fact, if one were to carry this traditional trade theory a step further, the ITC study could just as well have concluded that if only the U.S. trade deficit had not been cut by that $4 billion during the restraint period—if the trade deficit had only gotten a little bit worse--then the dollar would have fallen!

Obviously, that, like much of the ITC study, strains credulity.

Chairman GIBBONS. Yes, sir. Go right ahead.

Mr. MILLER. Now, as we all know, despite our strong protests and those from Congress, the President's Cabinet Council on Commerce and Trade recently announced its unanimous opinion that the voluntary restraints should not be renewed beyond March 31.

Now, as far back as October of 1983, Mr. Chairman, I believe Chrysler was first to publicly identify what came to be known as General Motors' three-pronged Far East strategy. We predicted then that GM hoped to accomplish three things of major importance to this Nation's trade and economic policy.

One, end the voluntary restraints so that the company could import great numbers of low-cost Japanese and Korean cars, knock-down cars and components. Two, bend the antitrust laws with a joint venture with Toyota in California so it could control the small car market. And, three, lobby to have the Federal fuel economy standards dialed back so the company could concentrate on selling higher-profit big cars without penalty.

As we look around us today, we see just how prophetic we were. The CAFE standards for light trucks have already been dialed back, and it seems certain that very soon there will be a push to do the same with respect to passenger cars.

The GM-Toyota joint venture is underway, although Chrysler is still vigorously suing to stop it. And from all government official statements, it now appears certain to us that the voluntary restraints on Japanese cars are going to be dropped, freeing General Motors to import those great numbers of built-up cars from its Japanese partners, Isuzu and Suzuki, as well as from its Korean partner, Daewoo.

In fact, just this month, Chevrolet's director of international marketing said that Chevy no longer—this is Chevrolet—no longer plans to build subcompact cars in the United States. Instead, he

said, and I quote, "We are now in business to import Isuzus and Suzukis in perpetuity."

Now, Mr. Chairman, I am a member of the board of directors at Chrysler and I am the company's head of finance. Given those responsibilities, I and others at Chrysler are bound to protect the interests of the company's owners and our current employees by making financial decisions that are prudent, given prevailing conditions, no matter how hard those decisions may sometimes be.

Now, up to this moment, Chrysler had been advocating a freeze for ourselves and for other importers of Japanese vehicles at the current levels. However, given the new running rules dictated by General Motors and the Administration, it is now clear that Chrysler will have to make the hard choice of adopting a parallel Far East strategy of its own.

It is apparent to us that General Motors wants a lion's share of the auto trade deficit. Well, I am here to say that Chrysler is forced to demand its own share of the auto trade deficit.

Now, there is no secret to building products in undervalued yen or Korean won, or wherever, and selling them in overvalued dollars. To that end, Mr. Chairman, in a matter of days Chrysler expects to be confirming to its Japanese partner, Mitsubishi Motors Corp., that we will require up to an additional 200,000 small Mitsubishi cars a year from Japan in addition to the 87,500 per year we presently import.

In other words, we are preparing to roughly triple our imports of built-up Japanese cars. Chrysler has a strong 15-year relationship with Mitsubishi. We already have the port facilities, the warranty agreements, the parts and service network. Our entire dealer network is familiar with Mitsubishi products. So, in essence, all we have to do is turn up the spigot.

The net result is that Chrysler will continue to be a strong and profitable company, although unfortunately much more of the products that we sell are going to be made in foreign countries by foreign workers.

Given the running rules laid out before us, we have little choice but to make this hard decision.

Thank you, Mr. Chairman. That concludes my testimony. Mr. Perkins and I will be happy to take any questions you may have.

Chairman GIBBONS. Well, thank you, sir. In a lighter vein, I am glad this book did not cost more than $35 because if it did, I would have to fill out a long form and report it. But I appreciate it, and I will see if I can get Mr. Iacocca to autograph it for me.

So many questions have been asked today, I hate to go back and repeat them all, but I know you have a particular interest in Japan and a particular expertise in the Japanese system.

Do you see any evidence that the Japanese yen is being manipulated by the Japanese?

Mr. MILLER. This is a very difficult question for us to answer. I think you have to take——

Chairman GIBBONS. Well, you all do business over there and over here.

Mr. MILLER. Yes, I know. We have been asked this before. I think you have to take into account all of the actions of the Japanese Government and its industry. They have refused to open up their

capital markets, so it is in the overall orchestration of their economy and a strong governmental role that has resulted in the current level of the yen to our detriment.

Chairman GIBBONS. Does the tax system that the Japanese follow and the Europeans follow, when contrasted with the U.S. profits tax—it give you competitive problems?

Mr. MILLER. Absolutely. We would echo the remarks by the witnesses from Ford here on that score. We have been working very hard to identify new forms of the way in which the United States should administer its tax system to put us on equal footing.

When we are the only country in the industrialized world that does not have a value-added tax or some equivalent form of tax basis, but instead put a heavy tax on the producing element of our economy, as a result we are bound to lose in a free trade environment, and we are losing.

Chairman GIBBONS. Well, I am glad to hear you confirm my suspicions—or maybe I am not glad to hear it; I am probably sad to hear it. But I have worked with the Japanese and with the Europeans for about 15 years now, explaining that America had perhaps made an improvident deal back in the 1940's when we agreed to these different types of tax systems and their rebatability at the border.

I regretted to see that in the President's—or I should not say the President's tax proposal because he has not proposed one—but in the Treasury word processor model of tax proposal that is so prevalent around Washington now, there is no item in there that really helps America's farms and factories overcome the rebatability of the value-added tax or the commodity tax.

Have you all expressed any regrets to the administration about that?

Mr. MILLER. Oh, absolutely, sir. My chairman has been at the White House and has been all over the Hill here repeatedly expressing his concern for the two main problems that we see.

One is the yen/dollar relationship, and second, and equally important, is the imbalance in our tax structure. We have made this point in every place where we can be heard, from my chairman on down.

Chairman GIBBONS. Have you all ever tried to put a dollar value or a per-car value on this rebatability?

Mr. MILLER. Yes, sir. We, in past studies, have estimated that approximately $600 of our cost disability versus the Japanese is attributable to the difference in tax structures between the two countries.

Chairman GIBBONS. Six hundred dollars per car?

Mr. MILLER. Six hundred dollars per car, and that is just the difference in cost between us and the Japanese producer. The bigger story is that a typical Chrysler car carries with it about $2,500 in taxes at the Federal, State, and local levels when it is sold in this country.

And when you substitute that for a Japanese car being sold here, then our State and Federal Governments lose about $1,700 per car. Now, the newspapers have been concentrating all on the effect on consumers of the Japanese restraints, they have focused entirely on price issues, and we find the treatment very debatable.

But what no one has been talking about is the drain from our Governments' tax revenues every time a Japanese car comes in here compared to a U.S.-built car.

Chairman GIBBONS. Well, Mr. Pease talks about it all the time. He is quite vocal in that area about it.

Mr. Frenzel?

Mr. FRENZEL. Thank you, Mr. Chairman.

I want to thank the witness for his testimony. You indicated that you had some advocates in the Congress who had introduced legislation in your behalf. Have you asked them to introduce relaxation or repeal of the CAFE limits, and do they intend to do so?

Mr. MILLER. No, we have not asked for relaxation of CAFE. We find ourselves in the position of having invested $7 billion in the last 5 years to completely overhaul our product programs so we can comply with the law, and we are frankly outraged that our competitors who have not made similar investments in order to comply with the CAFE laws are now asking that they be dialed back.

Mr. FRENZEL. You indicated that the auto agreement was a bargaining chip worth $5 billion. Do you want to explain your mathematics?

Mr. MILLER. $5 billion is the estimated impact on our trade deficit if the restraints were not to exist compared to maintenance of restraints on approximately today's level.

Mr. FRENZEL. That is not the $5 billion more that consumers have to pay. That is the number of cars times the costs of cars that you anticipate would come in?

Mr. MILLER. That is correct, sir.

Mr. FRENZEL. And, again, can you tell us what your figure is on the number of cars to get to the $5 billion? Is that the 40 percent that Mr. Brock is using or the three-quarters of a million that UAW is using?

Mr. MILLER. What we have estimated is that there would be an additional 750,000 vehicles brought in, in addition to the 250,000 CKD units we are talking about. We are talking about 1 million vehicles as the potential increase in Japanese penetration in the first year into this country.

And when you multiply it out times the per-car value that will be imported into this country instead of being built here, we are talking about a $5 billion hit to our trade deficit that is already a $37 billion negative with Japan.

Mr. FRENZEL. How many cars are you importing now?

Mr. MILLER. We are importing 87,500 cars, which is our share of the quota for Mitsubishi vehicles to be sold through Chrysler. That is about the same number as in 1970 when Chrysler and Mitsubishi first entered into this agreement.

There have been some ups and downs in the interim period, but that is about where it is. Our total sales of cars and trucks in the United States and Canada amounts to about 2 million vehicles per year, so it is a fairly small percentage of our total output. Most of our growth has been in the domestic area.

Mr. FRENZEL. And how many engines do you import?

Mr. MILLER. We import about one-quarter million engines from Mitsubishi.

Mr. FRENZEL. They do not count?

Mr. MILLER. Well, they certainly do count, but Chrysler did not have the investment funds available in the late 1970,s to reproduce the engine line those engines represent. In a more recent decision, we have decided to procure our V-6 engines from Mitsubishi.

And, again, we are responding to the pressures put upon us by the high-flying dollar and the tax disadvantages we labor under.

Mr. FRENZEL. I am sure the others are, too, when they are thinking of CAFE.

What do you import from Canada?

Mr. MILLER. We are in an approximate trade balance with Canada. Under the trade pact, all the cars that are sold to Canada are built in the United States and shipped north. Conversely, all of the vans and minivans in our North American system are built in Canada and shipped south. The result is an approximate trade balance between the two countries.

Mr. FRENZEL. How about the components of what you make in America and import from Canada?

Mr. MILLER. There, we are not quite in balance. We actually export more components into Canada than we bring back. We had to shut down our Canadian engine plant and, as a result, we have a trade surplus.

Mr. FRENZEL. The total value of your trade with Canada is a plus for the U.S. side?

Mr. MILLER. Well, a more accurate statement is it is approximately a balance, which is the intent of the auto trade pact, to provide duty-free trade as long as you stay in balance.

Mr. FRENZEL. Well, there have been very few times overall in the history of the pact that we have been in balance, but I think everybody likes the pact. Do you?

Mr. MILLER. We support it, yes, sir.

Mr. FRENZEL. You like it, OK. Well, I thank you very much, gentlemen, for your testimony. I think you have got a little different story than your friends and competitors at Ford. You have a little different kind of problem in front of you than they do.

I guess I am troubled a little bit by what happened to you in your negotiations in 1984, but labor negotiations are never easy.

Mr. MILLER. Well, I am sorry. We had negotiations in 1983, if that is what you are referring to.

Mr. FRENZEL. I am sorry; I was referring to that.

Anyway, I thank you very much for your testimony.

Mr. MILLER. Thank you, sir.

Chairman GIBBONS. Thank you.

This concludes the hearings for today. We will begin again next week.

[Whereupon, at 3:36 p.m., the subcommittee was adjourned.]

JAPANESE VOLUNTARY RESTRAINTS ON AUTO EXPORTS TO THE UNITED STATES

MONDAY, MARCH 4, 1985

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, DC.

The subcommittee met at 2 p.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman GIBBONS. Good afternoon, ladies and gentlemen. I am sorry we are a little late starting. As I am sure you know, just as we were ready to start, there was a very important rollcall vote on the House floor.

One of our witnesses is unable to be with us today—the president of the UAW, Mr. Bieber, was caught by very bad weather in Detroit. I have promised the UAW that as soon as they are able to, we will hear their part of the testimony.

Today we conclude, with the exception I have just made for the UAW, our hearings on the automobile export restraint agreement with Japan.

Of course, as all of you know, the President announced on Friday, March 1, that he would not urge the Japanese to extend their export restraints on autos, citing the expected benefit to U.S. consumers and the improved economic performance of the U.S. auto industry. Today, we will focus on the likely implication of that decision for U.S. auto workers, companies, and consumers.

Our first witness today is Hon. Stan Lundine, a Member of Congress from the State of New York.

Mr. Lundine, I welcome you before this subcommittee. I repeat I am sorry we had to delay your performance.

STATEMENT OF HON. STAN LUNDINE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. LUNDINE. Thank you, Mr. Chairman.

Chairman GIBBONS. I know your testimony is good because I have had an opportunity to work with you in the past, and have found you to be a very thoughtful, intelligent, and hardworking person looking for solutions and basing your decisions upon the facts with good inductive reasoning.

Mr. LUNDINE. Thank you very much, Mr. Chairman.

Last year, I appeared before this subcommittee during hearings you held on the U.S. trade deficit to underscore my belief that our international trading situation is rapidly deteriorating and in the process doing irreversible damage to our industrial economy. At that time, I submitted to you for your further study a report from

the House Task Force on Trade which I had cochaired for Gillis Long during the last Congress. As you might recall, that report identified the dimensions of our trade problem. It called for action, in particular, to address the problems of exchange rate imbalances, export promotion, trade law reform, industrial competitiveness, and trade adjustment.

The disturbing trend set forth in that report of last year continues unabated. The United States ended the month of January with a record $10.3 billion trade deficit. At this pace, our 1985 trade deficit could hit $145 billion. I am convinced that our trade deficit has the potential to undermine future U.S. economic growth, and believe we must take action to reverse the present trend. I am currently in the process of putting together legislative proposals to complement some of the sound recommendations which came out of the task force. In future weeks, I will be advancing these.

However, there is one specific aspect of our economy which these hearings are meant to address which is urgent and deserves our immediate consideration. As you have indicated, on Friday, President Reagan announced that he would not seek to extend the auto voluntary restraint agreement with the Japanese. This announcement is unfortunate and shortsighted. If left to stand, it will result in a tremendous surge in auto imports from Japan and cause American auto firms to intensify and accelerate movement to offshore production in an attempt to remain price competitive with the Japanese.

I have introduced legislation, H.R. 1060, to continue auto restraints on imports from Japan at the current 2.85 million unit per year level for about a year. At the same time, I am calling for the establishment of an Auto Strategy Council comprised of representatives of management, labor, government, and consumers to develop a strategy for future competitiveness in our auto sector. Last year auto exports from Japan constituted 20 billion of our present $35 billion trade deficit with the Japanese.

This is the greatest trade deficit any nation has ever experienced with any other. Some estimate that the Japanese have an unused productive capacity capable of producing up to 2 million more cars a year. Even our trade ambassador, a representative of the administration, indicated that he thought about 750,000 additional imported cars from Japan next year would come in with the restraints lifted.

The problem of outsourcing by American companies is increasingly serious. Both Chrysler and Ford have announced that they will follow General Motors' lead and produce more of their automobiles and component parts offshore if this policy pronouncement by the President stands.

I believe that an auto strategy counsel like I have proposed with a mandate through the end of this year to analyze how government, business, labor can work together to improve U.S. competitiveness and right some of the inequities from exchange rates that exist today, would be in the long-term interest for producers and consumers alike.

We cannot ignore the jobs picture in the United States. The auto industry serves as a market for 20 percent of our steel, 60 percent of our rubber, 11 percent of our domestic aluminum and 20 percent

of domestic glass and machine tools, including robots. We are not going to have a high technology industry if we don't have an automobile industry.

I don't have any automobile production plants in my district, but I have got an awful lot of companies that are tied into that major linkage industry. If we pull the plug on them today, I believe that it will be unfortunate. I believe the House has an opportunity for leadership in this regard. I am not in favor of permanent quotas. I rather am an advocate for doing all we can do to be competitive.

We have not had a strategy for our auto industry up to this point. It is not unreasonable to continue a restraint at the 1.85 million units for the balance of this year in an effort to come up with that kind of a strategy. Management, labor, government, and consumers working together, I believe, can develop such a strategy, can close the productivity gap, we can take some action to deal with the exchange rate problems. And I believe that our industry will be in a much better position, and our consumers' long-term interest will be much better served, if we were to extend these quotas for that limited reasonable period of time.

Thank you, Mr. Chairman.

[The prepared statement follows:]

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The work as co-chairman of that task force was a major influence on the evolution of the proposal I bring to you today to help deal with the future international competitiveness of our U.S. auto sector. As you know, on Friday, President Reagan announced that he would not seek to extend the auto restraint agreement with the Japanese. This announcement is unfortunate and short-sighted. If left to stand, it will result in a tremendous surge in auto imports from Japan and cause American auto firms to intensify and accelerate movement to offshore production in an attempt to remain price competitive with the Japanese. Since the President has chosen to take this position on this issue, it is now up to the Congress to act to control a surge of auto imports from Japan.

I have introduced legislation, H.R. 1060, to continue auto restraints on imports from Japan at the current 2.85 million unit per year level for about another year. At the same time, I am calling for the establishment of an Auto Strategy Council comprised of representatives of management, labor, government, and consumers to develop a strategy for future competitiveness in our auto sector. This council would make recommendations about actions which must be taken by management, labor, and government to have a competitive U.S. auto industry in the future.

The bi-lateral trading relationship between the United States and Japan in autos has the potential for devastating the future of our domestic auto industry. Last year, automobile imports from Japan constituted $20 Billion of our $35 Billion trade deficit with the Japanese. Some estimate that the Japanese have an unused productive capacity capable of producing up to 2 million more cars a year. Bill Brock has

testified that he believes we will see 750,000 additional imported cars from Japan next year if these restraints are lifted.

For several years, General Motors has been pursuing a policy of greater and greater outsourcing of foreign production, particularly in relation to small car production. It seems to me, somewhat ironically, that the exciting Saturn project recently announced by General Motors will encounter formidable, and perhaps insurmountable, obstacles as it tries to get off the ground if small car imports from Japan surge. Both Chrysler and Ford have stated that it is likely that they will also resort to greater offshore production in order to compete if the auto restraints are lifted. What this means is a flight of both U.S. capital and jobs to overseas production, and a serious undermining of a capacity to produce cars on U.S. soil.

I have serious questions regarding this as a future scenario for our U.S. auto industry. Rather, we should be looking, it seems to me, at how we can keep a competitive segment of auto production on U.S. soil in the years ahead. This is important to preserve jobs and to preserve our industrial base. The automobile industry serves as a market for 20% of our domestic steel, 60% of our domestic rubber, 11% of our domestic aluminum, and 20% of our domestic glass and machine tools, including robots. At the very least, I believe that we should make sure we understand and agree on the ramifications of removing these restraints before we do so.

There has been a great deal of discussion over the last few weeks regarding the impact on the consumer from the restraint program. The International Trade Commission has reported that the four years of auto restraints has cost the American consumer $15.7 billion. There is no question that trade restrictions carry with them a cost to the consumer, and I am very concerned about that. I believe, at the same time, however, that if we choose to go forward and lift these restraints now while our domestic industry is still very vulnerable, what we will find is that consumer benefit is very short-lived. Rather, over the long term what we will see is permanent job loss and an undermining of a U.S. capacity to produce cars. Over the long term, this will mean that prices of cars will be dictated by foreign producers instead of competitive factors.

I am not in favor of permanent quotas and am rather an advocate for doing all we can to preserve a competitive auto sector. A section of the International Trade Commission report which, unlike the consumer impact, has not received a great deal of attention finds that industry made substantial progress in improving competitiveness during the four years of restraints. This notwithstanding, the U.S. still has not closed the "productivity gap" with the Japanese, and the tremendous strength of the U.S. dollar on international exchange markets is providing the Japanese a $1,000 to $1,500 per car price advantage.

Removal of these restraints in this kind of an environment is tantamount to industrial suicide. Rather, if suicide is to be avoided, management and labor must work together to continue to make progress on improving productivity and the U.S. government must take effective action to bring the value of the dollar down.

Management, labor, government, and consumers working together can develop a strategy for the future for this critical industry. By necessity, it must involve investment in modernization and human resources by management, and a moderate approach to wages and benefits from labor. The government must come to grips with the factors keeping the U.S. dollar so high on international exchange markets, and consumers must be involved in decisions which will impact on their daily lives. Such an effort should have begun four years ago when these restraints were put in place. I urge you to look beyond the bottom line balance sheet for this year into the future. Support a continuation of these restraints to stabilize the international trading environment until we can figure our where we want our auto industry to go, why we are going there, and how we are going to get there.

Chairman GIBBONS. Thank you, Mr. Lundine.

Going back to your proposal, what reaction have you had from the auto industry and the UAW in general? How do they feel about the ideas expressed in your bill?

Mr. LUNDINE. As you know, the auto industry is somewhat divided on this issue. The General Motors Co., as I understand it, is in favor of immediately lifting the quotas. In my opinion, the reason for that is that they intend to import more from their Japanese partners in the coming year.

I have not discussed the matter with General Motors, but I can't believe that a 9-month or a year postponement to a time certain would disrupt those plans. Informal discussion with both other

major U.S. auto makers indicated that while it may not be all they want, it would certainly at the very least postpone discussions to outsource more right away.

Again, with the United Auto Workers, my conversations have been informal and I don't come here to testify for Mr. Beiber, but I would suspect they would find my approach to this problem more progressive than the President's.

Chairman GIBBONS. You and I both heard Mr. Iacocca this weekend express his opinion that he thought a 15-cent per gallon gas tax would help solve some of the problems that we have. Do you have any feelings on that?

Mr. LUNDINE. I have a strong feeling that we have got to deal with our budget deficit and that that is an integral part of correcting the imblance in exchange rates. A gas tax would not be my favorite way of reducing the budget deficit, but even a representative from a rural area that depends very, almost exclusively, on automobiles for travel must acknowledge that we have a big problem.

The dimensions of our trade and budget problems to my way of thinking are enormous, and I would not close my mind, nor would I promise to any constituent that I would outright reject what I have voted against in the past if that is a part of a package to get to a more sensible fiscal and international monetary policy.

Chairman GIBBONS. Like you, I find myself situated on the east coast of the United States. And another of Mr. Iacocca's suggestions was to impose a tax on imported oil. I have trouble with imposing such a tax on just imported oil, because it seems that those of us on the eastern shore of the United States would bear the brunt of it.

Do you have any opinion on that?

Mr. LUNDINE. Again, I agree with you. We just can't go on with business as usual. I found Mr. Iacocca much more indecisive in describing the problem than in coming up with solutions to it. But then again if not, his solution, whose? And frankly, I don't see a lot of solutions that are being offered that are verfiable.

You are entirely right, if you impose a fee on imported oil it falls disproportionately across the United States. I guess the only honest response I could give to you is what else would be in a package with that fee? I assume serious cuts in spending and maybe some other measures. If the total of those measures was in any way fair or reasonable from a geographical point of view, then my inclination would be to support it.

But clearly, if you look at it in isolation, a fee, a surcharge, or anything else you call it, which impacts very, very heavily on one part of the United States and not on others doesn't seem to be a fair way of dealing with the problem, even though it is an answer.

Chairman GIBBONS. A number of witnesses before this committee have suggested that the only viable solution is to reduce the Federal budget deficit, and thereby indirectly reduce the pressure which is keeping the dollar highly valued.

Do you have an opinion on that suggestion?

Mr. LUNDINE. Reducing the amount of the Federal budget deficit by the amount, I believe, politically likely will not solve the exchange rate problem in my opinion.

We have higher real interest rates—that is, the difference between inflation and prevailing interest rates—than at any time since 1942. If you are not afraid because of the deficit itself and because we are about to become a debtor nation, I think a thinking person has to consider what could happen if we allow those high real interest rates to continue for too long. What are the choices though?

Mr. Volcker can print money like crazy, but that is probably inflationary. We can try to reduce the Federal budget deficit—it isn't going to be easy.

If all you are dealing with—as I believe we are—only the spending side of the ledger, I doubt if we will be able to cut as much out of the deficit as the interest costs increase from one year to another.

Now, we have a big problem in my opinion and I don't pretend to have all the solutions to that problem, but I think we have to begin to think about bigger solutions.

At a time like this, I really hate to see a million more auto workers thrown out of work, not paying taxes in. I hate to see us do something by inaction or action that means that you are going to be outsourcing a lot more. I just don't think we can afford it.

The decision on auto restraints, in my view, has an impact on the budget because of how many people are paying taxes and what those revenues are. So I think we have to think of all these kinds of measures and perhaps consider others that in normal times we would be reluctant to engage in.

I don't see that our suppliers abroad—be they Japanese or Canadian, or however friendly a nation they may be—are going to be well-served if the United States indeed does go over a cliff. I honestly think that there is a lot of very objective, quantitative factors that indicate that we are headed for serious trouble with the amount of foreign debt we have.

We are going to make Brazil and Mexico and all those so-called indebted nations look like small-time borrowers rather soon. Add to that the trade imbalance, which means we are importing so much more than we are able to export. If this trend goes on for too long I just am deeply concerned.

I don't want to overstate it. But, I think the outlook for budget reduction is poor. The Congress should go as far as we can. I believe we should bring Mr. Volcker right into the table to help develop a package and say, if we do this on the fiscal side, how much can you do on the monetary side? How much can you reduce interest rates so we get sustained growth?

I think we have to look at things like the auto situation, in the context that we are in extraordinarily perilous economic times.

Chairman GIBBONS. Well, I agree with you. We certainly are in extraordinarily perilous times. The economic situation appears to me to be one in which we are watching a delightfully well balanced bubble that could burst at any time; and if it does then the panic starts in the exchange rates. We may have this problem in the exact reverse in a matter of a few weeks or few months.

Mr. LUNDINE. I was reading the other day where somebody asked Mr. Volcker—I think it was in the Economist—which is a foreign publication I realize—that asked if he was going to intervene in ex-

change markets, why won't he lean with the wind instead of against it. That is, wait until the dollar goes down and try and drive it further down. He said, because I might to be successful.

I agree completely with what the chairman has said. The volatility of this situation is likewise scary. What that means is that we are going to have big debt and we are going to have to pay it back.

Chairman GIBBONS. Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman.

I, too, would like to congratulate our colleague from New York for his testimony and I am pleased for him to call not for an indefinite extension of the voluntary restraints.

You mentioned about a year. Would that be from now until the end of 1985?

Mr. LUNDINE. What I propose to do is have an auto strategy council go into existence as soon as this law is passed and have it required to report back by December 31, 1985. Then give the Congress and the President 30 legislative days thereafter to react, should some legislation be required or the President have something in his power to do to help make that industry competitive. So I would estimate it to be less than a calendar year. It would be sometime in the first quarter of 1986 under that legislation. The limits would be removed completely after that time.

Mr. CRANE. Would that council include, presumedly, representatives from the industry, the auto industry, the labor unions, perhaps business and professional groups outside of the auto industry?

Mr. LUNDINE. I would put consumers in, business are the major consumers of automotive products, yes.

Mr. CRANE. One of the problems according to an FTC study of the plight of the auto industry, titled "A Time Series Investigation Into Factors Influencing U.S. Auto Assembly Employment."

Their conclusions were that the primary factor for a falloff in jobs in Detroit or the domestic auto industry, which is the result of the recession itself in 1980 to 1982, the secondary contributing factor was the excessive wage levels of U.S. autoworkers in contrast to manufacturing wage levels as a whole in this country, and contrasting those with the relationship in Japan between the premiums they pay to their autoworkers versus manufacturing on a whole, and third, they concluded that it was the increased competitiveness of Japanese products.

One of the things that strikes me in looking to the statements by Mr. Iacocca in relationship to the saying he would let the restraints die, is the Ministry of International Trade and Industry in Japan has warned the major automaker over there to exercise restraint, notwithstanding the lifting of our so-called voluntary restraints, and the greatest threat in today's Wall Street Journal, threat to imported cars from Japan comes from General Motors and Chrysler.

In fact, the estimates are that the Japanese affiliates of General Motors are anticipating an increase from 49,500 imports to 200,000 a year, and with Chrysler from 87,500 to 287,500.

This is a 19-percent increase in Japanese imports coming from our own domestic auto manufacturers. Whereas, the minister of MITI has leaned quite powerfully on the major Japanese auto manufacturers not to exploit this.

I am wondering in the light of Mr. Iaccoca's condemnation of the action how he reconciles that with Chrysler's plan to turn around and ask——

Mr. LUNDINE. I heard the speech, I don't know if I could give it to you exactly, but you see, Mr. Iaccocca says, I am a businessman, and you are putting me in this situation and I have no choice, the only choice I have is to go abroad.

He analogizes it to war—I don't like that analogy but he made that analogy when I heard him this weekend. In a wartime situation, you allow your enemy to determine how many of your armaments are beginning to be reduced.

Being a college basketball fan, it's rather like saying it would be like Georgetown playing St. John's and letting Lou Carnasecca determine who the referees are going to be.

It is just absolutely absurd that we who are making policy in the country on something this important would say, MITI, why don't you do it? I don't understand that.

We can make it right or wrong, but it seems to me that we ought to make that decision. I do kind of understand Mr. Iaccoca's point of view and others who say that if we make the decision to lift it immediately and totally, that to be competitive they would import more Mitsubishis or whatever.

Mr. CRANE. Could I interrupt for just a second? Is that not conceivably an excuse that they are using because in the light of the minister of MITI's comments—and this is public information—using the end of voluntary restraints as an excuse to drastically increase imports, in as of yet the absence of a huge surge in Japanese exports to this country, it reminds me a little bit of the call on the part of the auto companies for the restraints in the first place.

They properly took advantage of those restraints, and greatly increased the prices and they produced record profits in 1983. They exceeded that in 1984 and 1985, looks like even a better year.

It is a little hard for me to grasp the rationale behind Mr. Iaccoca's announcment and intentions in the absence of that kind of possible threat to his particular phase of the industry.

Mr. LUNDINE. Well, I did not come here to represent Mr. Iaccoca, but I think that it is undeniably that one fact resulting from these VRA's has been higher auto profits both here and in Japan.

It is undeniably that they are concentrating for the upper end of the scale. It is also my understanding that the Japanese have allocated so many units in such a way as gives the top two manufacturers, Toyota and Nissan, a fairly comfortable situation.

But it is the other competitors waiting to get into the game. One point I would make is that it is not just units of total Japanese cars that I am worried about long term and why. I think a strategy council could be useful.

For example, in my hometown we have a TRW plant that makes ballbearings. How many ballbearings are coming in in cars when they, that is foreign competitors, already have more than 50 percent of the ballbearing market. How many times are we going to see the high value added products and so on, engines, transmission, et cetera, made abroad, and we get the double dirty dangerous jobs of assembling them here in the United States.

That doesn't make much sense for the leading industrial country in the world from the standpoint of the long term, it doesn't make much sense for consumers.

I don't take any comfort just because they put Chrysler or Ford or General Motors on the nameplate on a car.

That is not what seems to me that we as policymakers ought to be most preoccupied with. We ought to be preoccupied with jobs, we ought to be proccupied with competition—real competition—and I think that this kind of a transitional measure initiated by the Congress would be possible in terms of seeing that kind of real competition and forestalling even more decisions to outsource more component parts as well as total units.

Mr. CRANE. I like your idea about a strategy council. I think they should have done this a long time ago without congressional initiative because there are evidences, I think, of some predigious mistakes made by management in the auto industry, the labor unions and Government that have contributed in the past to enormous difficulties in maintaining our traditional competitive engine.

I think the most possible ultimate thing probably we can all do in Congress is deal with the deficit and thereby exert some pressure on that dollar downward.

I want to commend you for your testimony and thank you for appearing.

Mr. LUNDINE. Thank you. I would like to make one comment back to that.

We are closing the productivity gap. It is still there, but we have been making some progress to close it. I think some of the American car companies are making some progress in terms of product quality, and again, I hate to see that dissipated suddenly.

Chairman GIBBONS. Mr. Guarini.

Mr. GUARINI. Thank you very much, Stan, you certainly articulated the problem very well.

We do need a clear national trade policy. We are uncoordinated, fragmented. We are really tired of being taken advantage of as a trading partner by Japan.

I remember when I was in Japan with the chairman on a trade mission, we went to the Japanese shipyards and there were no ships there, and we asked what happened and how things were going in their industry, and they said, "Well, Korea now gets all the action. We can't underbid Korea because their steel is cheap and their labor is much cheaper than ours."

We should have a national strategy but I wonder what you see in that clouded crystal ball where we will be as a nation? It doesn't look very good. How do you put $22 an hour against $1 an hour wages and still have a major industry supplying our people with automobiles.

Mr. LUNDINE. I personally believe that we can be competitive in automobiles for as far into the future as I have any capacity to see. There are high value-added products with high levels of skill needed to build them, and I really welcome international trade. It was amusing to me on another panel on this same issue to hear an advocate for the Japanese say that, "We are not so concerned what you do about the restraints on Japanese cars, but watch out for the

Koreans." Well, that is the point, really, that you have just made, only it was made out of other perspectives.

The Japanese have been quite successful in not managing, but sort of directing their economy and developing strategies of their own. If shipbuilding, for example, is not promising for the future, they have been relatively good at making an adjustment over to another industry that can afford to pay a higher wage. They know the only way that you increase your standard of living is to be able to support industries that can produce and sell competitive products that are made by people who demand high wages.

As we are able to automate further, the labor costs differential becomes less important. I am excited that General Motors has undertaken the Saturn project. That, as I understand it, will have innovative technology and also innovative ways to actually man the production process to build the car.

In my own district near Jamestown, NY, Cummins Engine Co. has the most productive truck plant in the world, they have told me, where they build truck engines with teams of workers with the most advanced technology.

They say they will put that up against virtually any competitor. The only thing we need to do is have some strategic sense of where we are going, where we can afford to go, and reasonable people can differ about this.

My sense is that my colleague, Mr. Crane, is correct that we should have done this 4 years ago when we first started giving relief to this industry. We should have said to them this isn't going to be a freebie, you are going to have to get together and tell us periodically how you are doing in terms of competitiveness.

We don't do that. The Japanese do. That does not to me suggest we should adopt their methods. It simply is that you find an American way, market oriented to try to strategize. I don't have the future of the American automotive industry on some kind of a blueprint that I have, but all the analysis I am able to absorb indicates to me that we can have a future here if we make good strategic decisions, and we expect a lot out of our companies, and their workers, and suppliers.

Mr. GUARINI. Japan has done well in harnessing their energies and talents by coordinating government, industry and labor and working out a long-range national policy. I agree it is about time we did that, too. But do you view this VRA as an emergency that we need to carry us through a difficult era? Do you think the long-range is looking at quotas as Europe has experienced?

Mr. LUNDINE. I view it honestly, as I have stated in the legislation, as a temporary thing and I think we would be making a mistake to adopt what I consider the rather sterile approach of most of the European countries.

It is interesting, you look at many of those European countries who are able to export and they actually have the most open market—Sweden, for example—is a country that has a virtually open automotive market. I think that is true. Yet they are a net exporter of cars. I don't think that that is totally an accident.

Mr. GUARINI. Thank you very much.

Just one last point. Even our tax lawyers are geared against the automobile industry with a commodity tax benefitting Japan and

we don't have that value-added tax advantage they have in the auto industry.

We do many things to ourselves to create the problem we have today and we certainly have not acted very wise. I look forward to us having a more intelligent program in the future.

Thank you, Stan.

Mr. LUNDINE. That is the issue that I think a strategy council ought to look at.

Mr. LUNDINE. Right.

Chairman GIBBONS. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

I thank our colleague from New York for his very thought-provoking testimony.

Stan, do you see a day in the future when America will be able to produce cars and sell them around the world?

Mr. LUNDINE. Oh, yes. I am not sure that we will make them all here and ship them elsewhere but I think Ford's success in Europe is an example of international competition that is a case where American manufacturers can successfully compete in northern markets.

What I would like to see——

Mr. SCHULZE. They are building the product there, however.

Mr. LUNDINE. By and large, yes, but that means a certain amount of research jobs and so on would be here.

What I would like to get to is the day when we ship the most significant highly technical parts of automobiles over there and they put them together, as I said, with the lesser skilled and incidentally more dangerous dirty jobs.

That would be ideal to me. That is how we could increase our standard of living of being able to afford rather highly paid jobs with environmental protection and safety and all that.

So idealistically that is what I would like to look for.

Mr. SCHULZE. Each time in the past, the automobile industry has come into my office and asked me to support some sort of voluntary restraint agreement, I have asked them, "How long, how long will it take you to be competitive?" I have never gotten an answer to that question. I am about at the end of my line. I have supported protection in the past but I don't intend to any more, especially with the enormous bonuses that were given to some of the executives in the automobile industry and the huge profits.

I was exorcised and have been for many years by the fact that the Japanese protected their domestic market, built up their television production capacity, efficiency, facilities, and then dominated the world market.

We were irate with that. In fact, we have done the same thing with our domestic automobile industry, but they have not come through in these 4 years. They are making huge profits and it seems to me that they are lining their pockets. But they have not concerned themselves with being competitive in the international market so that after 4 years of protection they still are asking for more. It just seems to me that there has to be a limit.

I know your legislation says let's just do it for another year, but I think your legislation, frankly, is a little late. We should have done that a couple of years ago and said: "Look, sure, we are willing to

help for a certain matter of time, but we can't go on indefinitely doing this." We are penalizing the American people in the same way the Japanese penalized their people to build up their television industry.

So how long do you think we should go on?

Mr. LUNDINE. Well, I am being straight and open. I think we ought to set it for them. I think it ought to be 1 year or less and in the meantime we should get together with them. If you have a complaint about rebate of value-added tax, we want to hear it and we want to hear your complaints, about the bonus and whatever, you mentioned, and see whether we can't have a better situation by the end of the year than we do now.

I understand your frustration and——

Mr. SCHULZE. That sort of, in effect, says: "We here in Washington know a hell of a lot better than you people producing cars know how to do this." I don't think that is true.

Mr. LUNDINE. We are making a decision whether we act or not. If we don't take action the restraints go off April 1, and we are saying to MITI or somebody, we seed it to them to determine the number of imports.

Mr. SCHULZE. We are really saying to General Motors, Chrysler, and Ford, you know, you determine how many imports—aren't we? Aren't we? We are not really doing that. We are saying, meet the competition, General Motors, you can dominate the market if you want to.

Mr. LUNDINE. No, no, and if MITI doesn't restrain them they will go and buy Isuzus and Mitsubishis and they will bring them back and they will put all sorts of American sounding nameplates on them, and sell them in Pennsylvania and where will we be? We will be a few billion dollars more in red ink in the budget deficit because people will have lost their jobs. They won't have any less bonuses necessarily at General Motors but we will be out a lot of jobs.

I don't think I know more about the car business than Mr. Smith, or Iacocca, or anybody else, but I do think that I understand we are making a decision, by acting or not acting.

I clearly understand your impatience at this situation and I admit you are right. My legislation is 4 years too late. But I would say looking at the situation right now we will be better off if we try to get our act together for the period of gestation than if we pull the plug on them April 1.

Mr. SCHULZE. Why not an import surtax?

Mr. LUNDINE. I was hoping that that would be a question that wouldn't be asked by this panel. I really don't know how to answer that.

I have been quoted, I guess, in the papers as being interested in that and I have talked to many people about it.

Mr. SCHULZE. The gentleman is aware of a bill which I have introduced which puts a 20 percent import surtax that says to any nation in the world, you can eliminate that simply by sitting down and negotiating a bilateral agreement which would give us an opportunity to say, we have problems with these nontariff barriers or tariff barriers, whatever it is.

And in other words you open your market and we will get ours open. I am convinved GATT is useless.

Mr. LUNDINE. I am convinced you are right and intended to have an off-the-record discussion with the gentleman before this time about it. I would welcome that in the future. I think that any surcharge proposal, though, is so serious that we ought to really very carefully consider the consequences of the thing before we rush forward.

That is not to say that I am condemning it but the effect on exchange rates has to be very seriously considered. The impact in terms of inflation has to be thought about very seriously. I get tired of hearing about retaliation. When we are down below the level point by $125 billion, when we have a trade deficit with everybody in the world, I am amused by thoughts about retaliation because the fact is we are buying more than we are selling.

But I am prointernational trade and I have been given information and advice that I would rather not repeat here today, but I would be happy to talk to the gentleman about it at any time off the record. My information indicates to me that such a wide sweeping measure needs to be thought about very carefully before we rush forward.

As far as the other aspect of your bill, I think it is totally salutory. I represent an area including Corning, NY, where they developed the optical wave guide associated with fiber optics. American companies, not necessarily Corning Glass, have 95 percent of our fiber market, 20 percent of the European market, 10 percent of the South American market, and zero percent of the Japanese market.

I have had an opportunity to speak to the chairman of NT&T about that and he told me they were very concerned about it. I told him we were, too, but nothing has happened. We still have zero percent of their telecommunications market.

Recently I had an opportunity to talk to the chairman of one of America's largest corporations that is the equivalent of NT&T here in America, newly deregulated, hoping to sell his products all over the world and guess what, nowhere in the world is there an open market for telecommunications.

I like the reciprocity principle, I am just not sure the surcharge threat is the proper way of getting at it.

Mr. SCHULZE. Come up with another one and we will use it.

Mr. LUNDINE. I knew that was your next question.

Mr. SCHULZE. I thank the gentleman.

Chairman GIBBONS. Mr. Frenzel.

Mr. FRENZEL. Mr. Chairman, I have no questions. I thank the gentleman for his testimony.

Chairman GIBBONS. Mr. Lundine, before you leave, I want to say that as always I appreciate your coming here and talking with us. Thank you for your thoughtful and thought-provoking testimony.

Obviously, you are well informed. One of the things that I hope this committee will take up—and I am going to try to get on the agenda very early—is the issue arising from the GATT rules dealing with the rebate of taxes at the border.

After World War II we set about to save the world from communism. There was a good chance that Europe would go Communist, there was a great fear that Japan would go Communist and we set

up a number of rules that were tilted toward them to help them rebuild their societies.

We often concentrate our attention on the dollars we gave them under the Marshall plan, but the dollars we gave them under the Marshall plan were very limited in number.

The technical assistance we gave was small, but we gave them some very distinct advantages, and perhaps the greatest advantage was what we did to our own currency. We established a fixed exchange rate system, and we vastly overvalued our dollar.

The impact of all of that was that the businesses in Japan and in Europe immediately had foreign markets they could expand into and they did. Europe rebuilt itself on export trade, Japan rebuilt itself on export trade, and it took us until 1970 to get that tilt out of the over-valued dollar.

That was perhaps the most important stimulant in rebuilding those two great areas of the world and saving them from communism, as we were dedicated to doing in the 1940's.

Today for some reason or another our dollar is still highly overvalued.

One of the reasons is that we allowed them to rebate at the border. Their costs of government were borne by taxes like the VAT or the commodity tax. In addition, we allowed them to impose their cost of development on our goods as they went into those markets. For years, because we were highly productive and efficient, we did all right.

Now that gap has been closed. We are still highly efficient and highly productive, but when you compare our rates with the productivity that the Japanese, the Europeans, and other people around the world have gained, we are not as far ahead as we once were. That is where the pain is really coming in right now. So I am going to start some hearings, I hope within a month asking the question, are the GATT rules outmoded?

What is the impact on the American economy of these taxes that are levied in other countries where the country is allowed to rebate that tax at the border, their cost of government at the border? Our goods have to go forth in the world carrying the entire American cost of Government plus the cost of government imposed on them when the commodity tax and value added tax is imposed upon them when they get to the foreign shore.

I think that perhaps at one time the economic effects of these rebates were washed out in the exchange rate system, but exchange rates are no longer driven by balances of trade. Exchange rates are now apparently driven by financial matters and by security matters. It seems to me we have placed ourselves in a horribly disadvantageous position and we must correct that.

It will perhaps require restructuring of some of our international rules, but I think it is time to begin. I would like to have you think about that. I would like to have your counsel and guidance on that as we go forward. I will certainly be asking my fellow committee members to think about it and seek their counsel and guidance.

Thank you for coming.

Mr. LUNDINE. Thank you very much.

Chairman GIBBONS. The International Union of Automobile Workers and Aerospace and Agriculture Workers have asked be-

cause of the bad weather in Detroit and the inability to fly, that Mr. Bieber's testimony be postponed until a more convenient time. We will do that.

As our concluding witness today, we will have a panel comprised of the Automobile Importers of America—Mr. George C. Nield, who is the president—and the American International Automobile Dealers Association—Mr. Robert M. McElwaine, the president, to be accompanied by Mr. Steven Horvath, the chairman.

Mr. Nield, we will be glad to hear from you first on this, and you may proceed as you wish.

STATEMENT OF GEORGE C. NIELD, PRESIDENT, AUTOMOBILE IMPORTERS OF AMERICA, INC., ACCOMPANIED BY BRUCE AITKEN, COUNSEL

Mr. NIELD. Thank you Mr. Chairman and members of the subcommittee. I am George Nield, and I am president of the Automobile Importers of America. I will call it AIA. We are an association of major European and Japanese manufacturers who market automobiles in this country.

Bruce Aitken is with me, of the law firm Busby, Rehm & Leonard. Mr. Chairman, our 18 members, of which 11 are European, strongly endorse the recent decision of President Reagan not to press for extension of the voluntary restraint arrangement. We unanimously urge that the VRA not be extended beyond its March 31 expiration date since the VRA is a quota which poses a significant threat to long-term international trade benefits.

Today I would like to focus on some short-term damage caused by the VRA and with your permission, Mr. Chairman, I will summarize my remarks and you can——

Chairman GIBBONS. We will do the same to you we have done with all other witnesses. We will place your entire statement in the record. Go right ahead and summarize as you wish.

Mr. NIELD. Several independent studies have been undertaken over the past 4 years on the impact of VRA on consumers. They generally reach the same conclusions. Automobile prices have risen significantly as a result of the VRA, and consumer choice has been restricted. The U.S. International Trade Commission found that the cost to consumers of the VRA from 1981 to 1984 totalled $15.7 billion.

The Federal Reserve Bank of Cleveland concluded that the effect of the quotas was to increase Japanese car prices by $1,114 in 1983. A U.S. Department of Commerce examination of the average transaction price, that is, what consumers actually paid for new cars, may tell the clearest story. The average price consumers paid for a new car rose from $7,591 in 1980 to more than $11,250 in the third quarter of 1984. This represents a 48-percent increase compared to only a 27-percent increase in the CPI during this period.

This translates to a $1,600 per vehicle increase over inflation.

Chairman GIBBONS. You are going kind of fast there. You said that was a 48-percent increase over inflation? How much was it—48 percent. How much was it over inflation in that time?

Mr. NIELD. It was a 48-percent increase including inflation.

Chairman GIBBONS. Yes.

Mr. NIELD. And inflation in that period was only 27 percent.

Chairman GIBBONS. Thank you, sir.

Mr. NIELD. If you convert that to a dollar amount that the consumer actually pays beyond inflation, it comes to $1,600 per vehicle. Now, this sharp increase in average transaction price may reflect, to some extent, a change in "product mix," with consumers buying a larger car with some more expensive options. However, consumer upscaling in the price and quality is a reflection of what has been available to the consumer under the VRA. As Hobart Rowen noted recently in the Washington Post, "try to find one of those advertised $5,499, specials at your favorite car dealer."

But what about employment? Any impact which the VRA has had on employment has been insignificant and very expensive. The U.S. International Trade Commission report indicates that the cost of the 44,100 jobs saved by the VRA in 1984 was $8.5 billion. This calculates to over $190,000 per job.

Chairman GIBBONS. Was that on a per year basis?

Mr. NIELD. Per job in 1984, yes.

Chairman GIBBONS. One hundred ninety thousand?

Mr. NIELD. Yes. My own view is that that number is on the conservative side.

Chairman GIBBONS. Whose estimate was that?

Mr. NIELD. The U.S. International Trade Commission.

Chairman GIBBONS. Thank you.

Mr. NIELD. Further, a recent study of the Federal Trade Commission found that the recession of the early 1980's and the high wages of U.S. auto workers, in relation to the average U.S. manufacturing wage, have been principally responsible for the automotive sector employment problems.

What is the present state of the industry? The domestic industry has had its breathing space from competition and no longer needs the protection of automobile quotas. As President Reagan said in his State of the Union Message, our automobile industry has overhauled assembly lines, increased worker productivity, and is competitive once again. We know that 1983 was a year of record profitability. And 1984 exceeded 1983. According to a recent article in Business Week, production for most U.S. built models is running full tilt. The industry will have trouble turning out more cars no matter what the market demands.

Total industry profits for 1984 hit new record levels of $10 billion. 1985 looks just as bright for the domestic industry. The Department of Commerce projects total new cars sales for 1985 at 11 million units, which would represent a 5-percent rise over 1984 results.

Further, Detroit's prosperity is likely to continue. The transformation of the cost structure of the domestic industry has placed it in a strong position to compete in the open market. As Fortune Magazine concluded recently, if the quotas are ended, Detroit is unlikely to return to its sick bed. Automobile quotas can no longer be rationalized. The time has come to return to competition.

There are enormous benefits to be derived from a return to competition both for the consumer and for the domestic industry itself. Car prices will be lower; consumer choice will expand; and as a

result the demand for cars will increase. With that increased demand for cars there will be increased employment.

Mr. Chairman, members of the subcommittee, the domestic automobile industry has clearly has recovered. With the industry enjoying record profits and American consumers paying record prices, AIA believes that the time has come to end automobile quotas and to restore the benefits of competition in the marketplace.

Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you.

[The statement of Mr. Nield follows:]

STATEMENT OF GEORGE C. NIELD, PRESIDENT, AUTOMOBILE IMPORTERS OF AMERICA, INC.

SUMMARY

1. The VRA has harmed the consumer

a. The average price of new cars rose from $7,591 in 1980 to $11,254 in 1984, a 48% increase, compared to a 27% increase in the Consumer Price Index. The result was a $1600 per vehicle price increase and a $16 billion cost to consumers for 1984.

b. The number of American jobs saved by imposition of this quota has been minimal and at a cost of at least $190,000 per job.

c. In 1979, an average worker paid the equivalent of 18.1 weeks of gross earnings to purchase a new car; in 1983, a new car cost the equivalent of 22.3 weeks of gross earnings.

2. The domestic automobile industry has recovered

a. The domestic industry was back on its feet by 1983. Sales jumped by over a million units, per car profits were nearly twice the level of 1975 and 50% higher than the general level between 1960 and 1980. Profits were at record levels.

b. U.S. car sales rose another 15% in 1984 to 10.5 million units. Total domestic industry profits for 1984 are almost $10 billion. Profits were even higher than the record levels in 1983.

c. In 1984 indefinite layoffs have been reduced by over 80% from January, 1983 levels and Chrysler plans to recall the last of its laid-off hourly workers and to hire new employees.

d. Detroit plans to boost production in the first quarter of 1985 to 2.2 million cars. The Department of Commerce projects total new car sales for 1985 at 11 million, a 5% rise over 1984 levels.

e. The restructuring of the Detroit manufacturers has insured their continued profitability.

3. There is a need for a return to competition

a. If quotas are continued they may become a permanent and expensive fixture that undermines the domestic industry's competitiveness. The cost of the restraints far exceed their benefits.

b. The benefits to be derived from a return to competition include: (1) price restraint; (2) expansion of the consumer's range of choice; (3) an increase in new car sales.

4. There will be no flood of Japanese imports should the VRA be lifted

a. Japanese competition is significant only in the subcompact and compact markets.

b. A rapid increase would not be feasible or sensible.

c. U.S. law can prevent a flood.

d. Detroit can and will compete for the U.S. market.

5. The overvalued dollar is the principal cause of the elimination of our overall trade surplus; continuation of the VRA is not a remedy

a. The continuing and growing budget deficit has contributed to the overvaluation of the dollar.

b. The U.S. economic recovery has preceded, and been more robust than, that of our trading partners, exacerbating the overvaluation of the dollar.

c. The serious loan repayment problems of some of our trading partners have further inhibited exports.

d. According to the recent report of the United States International Trade Commission, the VRA has not helped to reduce the merchandise trade deficit; it may have exacerbated it.

e. The merchandise trade deficit with Japan accounts for only 36% of the total deficit and has decreased from 57.3% in 1981.

6. Conclusion

The VRA has not benefited the overall trade balance and, in fact, may have had a negative effect on the trade balance and on economic growth. Its extension would impose a continued burden on consumers.

STATEMENT

Mr. Chairman and members of the Subcommittee. I am George C. Nield, President of the Automobile Importers of America, Inc. (AIA). AIA is an association of major European and Japanese automobile importers in the United States. Accompanying me is our counsel. Bruce Aitken, of the firm of Busby, Rehm and Leonard.

Mr. Chairman, our 18 member companies, of which 11 are European, heartily endores the recent decision of President Reagan not to press for extension of the Voluntary Restraint Arrangement (VRA). We unanimously urge that the VRA not be extended beyond its March 31, 1985, expiration date, since the VRA is a quota which poses a significant threat to long-term international trade benefits.

Today, however, I would like to focus on some of the short-term damage caused by the VRA and the likely effect of VRA expiration.

1. The VRA has harmed the consumer

a. The average price of a new car has increased due to the VRA

Several independent studies have been undertaken over the past four years on the impact of the VRA on consumers. They generally reached the same conclusions: automobile prices have risen significantly as a result of the VRA and consumer choice has been restricted.

Here is what these studies reported.

(1) *The U.S. International Trade Commission.*[1]—The U.S. International Trade Commission (ITC) concluded that costs of consumers resulting from the VRA grew substantially from 1981 through 1984. It found that higher prices on Japanese automobiles alone raised the consumer costs of the VRA from $351 million in 1981 to $1.8 billion in 1983, and by 1984, to $3.3 billion. The VRA also caused higher prices of new domestic autos. The ITC found that the combined costs of the VRA on both imported and domestic automobiles had reached $4.7 billion in 1982 and then climbed to $8.5 billion in 1984. The ITC found that the cost of consumers of the VRA during 1981–1984 totalled $15.7 billion.

(2) *Wharton Motor Vehicle Service.*[2]—Wharton found that automobile quotas raised the average price of new imports by over $850 during 1981 and 1982 and raised the average price of a new domestic car by $324 during this two-year period. It projected a further $1,000 price increase for Japanese imports in 1983 solely due to the quotas, and a $500 increase for domestic cars. The overall VRA price tag to the American consumer in 1983 alone, according to Wharton, was $5 billion. Wharton did not estimate the presumably higher cost of quotas for 1984.

(3) *Robert Crandall, Brookings Institution.*[3] In mid-1984, Robert Crandall, after a comprehensive study of the costs of automobile quotas through 1983, concluded that the VRA added about $400 on average to the price of a new domestic car between 1981 and 1983. With a $1,000 price impact on new Japanese imports. Crandall calculated that the total consumer cost for 1983 alone was $4.3 billion.

(4) *Federal Reserve Bank of Cleveland.*[4]—Michael Bryan and Owen Humpage, economists with the Federal Reserve Bank of Cleveland, calculated the impact of automobile quotas on Japanese import prices alone. They concluded that the effect of the quotas was to increase Japanese car prices by $11 per car in 1981, $273 in 1982, and $1,114 in 1983. They calculated the three-year cost to American consum-

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[1] "A Review of Recent Developments in the the U.S. Automobile Industry Including an Assessment of the Japanese Voluntary Restraint Agreements," Preliminary Report to the Subcommittee on Trade, Committee on Ways and Means of the U.S. House of Representatives in Connection With Investigation No. 332-188 (ITC Preliminary Report).

[2] Special Analysis: The Japanese Quotas: Wharton Motor Vehicle Service (Jan. 1983).

[3] R. Crandall, Import Quotas and the Automobile Industry: The Costs of Protection. The Brookings Review, 16 (1984).

[4] Bryan & Humpage. "The Costs of a Protectionist Cure." Economic Commentary, Federal Reserve Bank of Cleveland. (July 30, 1984).

ers in increased prices for Japanese imports at $2.7 billion. They did not calculate the impact on domestic care prices.

(5) *U.S. Department of Commerce.*[5]—An examination of the average transaction price (i.e., what consumers actually pay for their new cars), as reported by the U.S. Department of Commerce, may tell the clearest story. The average price consumers paid for a new car rose from $7,591 in 1980 to $11,254 in the third quarter of 1984. This represents a 48 percent increase, compared to a 27 percent increase in the Consumer Price Index during this period.

This translates to a $1600 per vehicle increase. This sharp increase in average transaction prices may reflect, to some extent, a change in "product mix," with consumers in some cases buying larger cars with more expensive options. However, consumer upscaling in the price and quality is a reflection of what has been available under the VRA. As Hobart Rowan noted recently in the Washington Post,[6] "try to find one of those advertised $5,499 'specials' at your favorite car dealers."

b. The cost of any jobs saved has been substantial

Any impact which the VRA has had on employment has been insignificant, and expensive. According to the Washington Post: [7]

> [E]employment in the auto industry is currently just about where it was in 1981, when the quotas were first imposed . . . about 44,000 jobs higher than it would have been without the quotas. Isn't that a good thing? Yes, for auto workers. But not for other workers. . . . Quotas don't save jobs. They just move unemployment from one industry to another. With the auto import quotas, the Reagan Administration established an international cartel—one that, in its cost to the American consumer, now ranks second only to OPEC.

The number of American jobs that may have been preserved by the VRA has been minimal, and at a substantial cost to the American consumer. The ITC calculates the cost of the 44,100 jobs saved by the VRA in 1984 at over $190,000 per job. Over four years, the ITC calculates the cost of jobs saved at over $267,000 per job.[8]

Import competition was not the primary cause of the decrease in U.S. auto assembly employment which occurred prior to imposition of the VRA. This was the conclusion of the ITC in its 1980 decision in the automotive escape clause case and of a recent study by the Federal Trade Commission (FTC).[9] Instead, according to the FTC study, the recession of the early 1980's and the high wages of the U.S. auto workers, in relation to the average manufacturing wage, have been principally responsible for automotive sector employment problems.

c. The VRA has made it more difficult for the average American to buy a new car

The real cost of the VRA to the consumer is perhaps best understood in terms of the number of weeks an average American worker must work in order to buy a new car. In 1979, an average worker paid the equivalent of 18.1 weeks of his or her gross earnings in order to purchase a new car. In comparison, in 1983, the same worker had to pay the equivalent of 22.3 weeks of gross earnings to purchase a new car.[10] The reason is that the VRA has induced the manufacturers, domestic and foreign, to charge more for their cars than they could in an open market.

As new cars have become more and more expensive, many potential new car buyers have been forced to postpone their new car purchase. In 1979, the average age of passenger cars in use in the United States was 6.4 years. By 1983, the average age of a passenger car had increased to 7.4 years.[11]

2. The domestic automobile industry has recovered

The domestic industry has had its "breathing space" from competition and no longer needs the protection of automobile quotas. Buoyed by the economic recovery, automobile sales have rebounded strongly and domestic auto industry profits have

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[5] U.S. Department of Commerce Office of Auto Industry Affairs.

[6] Hobart Rowen, "Detroit's Quota Crunch." The Washington Post, May 10, 1984, at A19.

[7] The Washington Post, February 21, 1985.

[8] ITC Preliminary Report, supra.

[9] David G. Tarr and Morris E. Marke, Aggregate Costs to the United States of Tariffs and Quotas on Imports; General Tariff Cuts and Removal of Quotas on Automobiles, Steel, Sugar and Textiles—An Economic Policy Analysis. Bureau of Economics Staff Report to the Federal Trade Commission, (December 1984).

[10] "The U.S. Automobile Industry, 1983," Department of Commerce, December, 1984.

[11] Id.

soared. As President Reagan said in his State of the Union message, "our automobile industry has overhauled assembly lines, increased worker productivity and is competitive once again."

a. 1983 was a year of record profitability

The domestic automobile industry was clearly back on its feet by the end of 1983. With the U.S. economy in a period of strong growth, total U.S. car sales rose by 15 percent in 1983. Almost all of that growth went to the domestic automobile companies whose sales jumped by over a million units.[12]

Shielded from vigorous price competition by the VRA, the big three automaker profits rebounded strongly. In 1983 General Motors showed a profit of $3.7 billion, Ford $1.9 billion, and Chrysler $.7 billion, a record.[13] Per car profits were even more dramatic—nearly twice the level of 1975 and 50 percent higher than the general level between 1960 and 1980.[14]

b. 1984 exceeded 1983

1984 was an even better year for Detroit. Total U.S. car sales rose another 15 percent above levels to 10.5 million units.[15] according to a recent article in Business Week. "[p]roduction for most U.S. built models is running full tilt. . . .The industry will have trouble turning out more cars, no matter what the market demands." [16]

According to the Department of Commerce,[17] in 1984, production increased about 18.5%. The U.S. industry's labor productivity has improved significantly since 1980. It now stands well above productivity levels in 1973 and 1978, the last two record production years.

Total domestic industry profits for 1984 hit new record levels of $10 billion. General Motors reported a profit of $4.5 billion, Ford $2.9 billion, and Chrysler $2.4 billion.[18]

The increase in the auto industry's profitability was just one aspect of the health of the industry. There also was a great improvement in the long-term debt-to-equity ratio. According to the Department of Commerce, the combined long-term debt-to-equity ratio for General Motors, Ford, Chrysler and American Motors declined significantly from .34 in 1981 and .37 in 1982 to .16 in 1984—another indicator of the health of the auto industry.[19]

c. Employment has increased

As a result of increased domestic production and strong sales domestic auto employment has increased. Indefinite layoffs in the industry have been reduced by over 80 percent from January, 1983 levels.[20] Chrysler Chairman Lee Iacocca recently announced the company's plans to recall the last of its laid-off hourly workers and to hire new employees for the first time in several years.[21]

According to the Department of Commerce: [22] average U.S. employment for the five largest domestic auto manufacturers during 1983 was 723,000 persons, a 5.5 percent increase over 1982. . . .; the average automotive employment rose 8.7 percent from 1982 to 1983 and by 19.7 percent in the first half of 1984 compared with the same period of 1983.

d. 1985 is likely to be another record year

1985 and beyond look just as bright for the domestic industry, with or without quotas. According to Business Week, "[e]uphoric auto makers expect more of the same in 1985." [23] Detroit plans to boost production in the first quarter of 1985 to 2.2 million cars, the highest level in five years.[24] The Department of Commerce projects total new car sales for 1985 at 11 million, which would represent a 5 percent rise over 1984 levels.[25]

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[12] MVMA Motor Vehicle Facts & Figures: 84. Motor Vehicle Manufacturers Association, 1 (1984).
[13] Fisher, "Can Detroit Live Without Quotas?" Fortune, June 25, 1984, at 20.
[14] Crandall, supra.
[15] U.S. Department of Commerce Office of Auto Industry Affairs.
[16] "Why U.S. Carmakers are on Easy Street," Business Week, November 19, 1984, at 47.
[17] U.S. Department of Commerce Office of Auto Industry Affairs.
[18] Washington Post, February 14, 1985.
[19] U.S. Department of Commerce Office of Auto Industry Affairs.
[20] U.S. Department of Commerce Office of Auto Industry Affairs.
[21] "Iacocca: We're Calling Back Everybody," *USA Today*, November 13, 1984.
[22] "The U.S. Automobile Industry, 1983", Department of Commerce, December, 1984.
[23] "Why U.S. Carmakers Are on Easy Street," *supra* note 47.
[24] *Id.*
[25] U.S. Department of Commerce Office of Auto Industry Affairs.

According to the ITC, "[i]f profits in January-March, 1985 are projected on the basis of January, 1985 sales (which were 12 percent ahead of those in January, 1984), then the domestic industry will generate at least an additional $3.2 billion in profits by March 31, 1985, when the current voluntary restraint agreement is scheduled to expire." [26]

e. Detroit's prosperity is likely to continue

The transformation of the cost structure of the domestic industry has placed it in a strong position to compete in an open market. Chrysler, for example, has lowered its breakeven point from 2.4 million units in 1980 to 1.1 million units today.[27] The domestic companies have reduced their inventory costs by $4 billion, trimmed management ranks by 15 percent, and reduced their workforce considerably.[28] A recent Dun & Bradstreet survey of Americans who plan to buy a new car in the next six months indicated that 85 percent of those who now own U.S. built cars would buy American compared with 51 percent of those who now own foreign cars.[29]

With an expected $10-11 billion of profits, rising production and sales, declining unemployment and mounting optimism, it is hard to visualize this as an ailing industry in need of further consumer subsidy. In short, as Fortune magazine concluded recently, if the quotes are ended, "Detroit is unlikely to return to its sickbed." [30] Automobile quotas can no longer be rationalized. The time has come to return to competition.

3. There is a need for a return to competition

a. Detroit cannot be treated as a permanent invalid

To continue automobile quotas under the present circumstances—with the automobile industry at a record level of prosperity—is to run a significant risk that, like other protectionist actions instituted in the past as "temporary" measures, automobile quotas will become a permanent and expensive fixture. Recent history indicates that this is a prescription for industry inefficiency, not growing competitiveness. After nearly two decades of some form of protection for the steel and textile industries, for example, neither is more competitive today than at the outset of protection. Meanwhile, the cost to the American consumer—and to the American economy—has been enormous: $180,000 per job created in steel, $12 billion a year for apparel and textiles.[31]

Removal of the VRA would force Detroit to become more competitive with Japan. In response to questions from the Chairman of the Subcommittee on Economic Stabilization on February 19, 1985, Kenneth Whipple of Ford Motor Company admitted that to build roughly the same size small car it takes 155 hours in Detroit compared with 110 hours in Japan. Detroit has indicated that it can improve its efficiency, with the announcement that GM's new Saturn automobile will be made with substantially reduced man hours per car. In addition, Detroit's competitiveness and its employment could increase by wage restraint. As Mr. Whipple stated at the February 19, 1985, hearing, "there is still a large gap, not only in terms of dollars per hour but in terms of hours per car." [32]

Detroit could improve its competitiveness by restraining the costs of labor. According to the Department of Labor, American automotive workers make more than twice the hourly wage of Japanese automobile workers.[33] The payroll cost per unit of a new car in 1978 was $1,666. In 1983 that had risen to $2,196.[34] UAW's wage scale continues to rise. According to the Department of Commerce:

> Under the terms of its current U.S. contract, Chrysler's labor costs in the United States are likely to increase from about $21 to $26 per hour by October, 1985.

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[26] ITC Preliminary Report, supra.
[27] Id.
[28] Id.
[29] "American Cars Remain Popular," Washington Times, December 5, 1984.
[30] Fisher, supra.
[31] William R. Cline, "Protectionism: An Ill Wind Riser." The Wall Street Journal, November 6, 1984.
[32] Hearing on the Competitiveness of the U.S. Automobile Industry, Subcommittee on Economic Stabilization, Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, February 19, 1985.
[33] Cited by the Secretary of Commerce to Representative John D. Dingell, undated letter, in response to queries from Representrative Dingell.
[34] U.S. Department of Commerce Office of Auto Industry Affairs.

This is substantially more than the average manufacturing employee in the United States. According to Michael C. Munger of the Federal Trade Commission:

> In sum, . . . lowering motor vehicle wages would expand employment in the industry more than eliminating any increase in Japanese competitiveness. Further, since increased import competition was not the primary cause of using import restrictions to assist the industry.[35]

By the time that the VRA took effect in April, 1981, U.S. auto workers were making 159% of the hourly average wage earned by workers in U.S. manufacturing as a whole and this increased to 167% in 1984.[36] If these wage levels had been reduced even slightly to 126% of the all-manufacturing average—the level that auto wages occupy in Japan in relation to average manufacturing wages there—in the 18 months preceding imposition of the VRA, then employment in the auto industry would have increased by 16.9% during that time period alone, according to the U.S. Department of Commerce.[37]

Detroit must be induced to maintain its competitiveness, and this can be accomplished by ending automobile quotas now, before they become a permanent habit.

b. Substantial benefits will be derived from a return to competition

There are enormous benefits to be derived from a return to competition, both for the consumer and the domestic automobile industry.

(1) *Car prices will be lower.*—If the VRA ends, automobile price restraint will be restored. With the average price of a new GM car reaching $13,000.[38] renewed price competition is vital before "sticker shock" becomes "sticker paralysis."

The Council of Economic Advisors, after examining the effects of lifting the VRA, concluded that domestic small car and average Japanese car transaction prices would decline by $260 and $1,200 per car, respectively, following elimination of the restraint. Consumers would realize a $4.1 billion first-year benefit from the elimination of the VRA as average car prices fell and total car purchases increase.[39]

(2) *Consumer choice will expand.*—The consumer's range of choice will be expanded, both by eliminating the artificial scarcity that has accompanied quotas and by stimulating, through vigorous competition, even greater product innovation.

(3) *Demand will increase.*—With renewed competition holding down prices, pent up demand for new cars will be released. As many as 2 million American consumers who now buy used cars are likely to buy a new small car if they can afford one.[40] Thus, competition will stimulate greater demand, production and employment.

4. *There will be no flood of Japanese imports should the VRA be lifted.*—Advocates of a continuation of the VRA claim that Japanese cars would flood the American Market should the VRA be removed. Dr. Marina V. N. Whitman, Vice President and Chief Economist of General Motors, told the U.S. Senate Committee on Commerce in August, 1984 that Japanese market share is unlikely to increase beyond 25%.

Similarly, Wharton Econometric Forecasting Associates estimates that in a free market environment the total import market share (of Japanese and other manufacturers) would reach about 25% by 1992. This would represent an increase in imports of less than 2% above the 1984 23.4% level. To a large degree, future import share depends upon how the domestic companies respond to renewed competition. One recent study of the auto industry concludes[41] "a 7% reduction in relative labor costs in the United States or a 7% increase in productivity or a 10% appreciation of the yen relative to the dollar, or some combination of the three is sufficient for the United States to hold the imports from Japan after [the end of the quotas] at the level these imports reached under the [quotas].

(a) *Japanese competition is significant only in the subcompact and compact markets.*—Japanese imports compete primarily in the subcompact market, with a few models in the compact market. The market for these cars is shrinking. The Department of Commerce study shows that demand for small cars, including subcompact and compact cars, decreased 11% from 1982 to 1984.[42] Consumer demand is grow-

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[35] Munger, FTC, supra.
[36] U.S. Department of Commerce Office of Auto Industry Affairs.
[37] Id.
[38] "Detroit," United Press International, August 31, 1984.
[39] "Economic Report of the President Transmitted to the Congress February 1985"
[40] "American Cars Remain Popular." Washington Times. December 5, 1984.
[41] Roy, Rassuli, International Trade Barriers and the United States Automobile Industry, 14 Toledo L. Rev. (Winter 1983) at 263: "The U.S. Automobile Industry: 1980."
[42] U.S. Department of Commerce Office of Auto Industry Affairs.

ing stronger in the intermediate, full size and luxury markets, where the Detroit manufacturers are strongest, because of stable or decreasing fuel costs.

(b) *A rapid increase would not be feasible or sensible.*—There is no evidence to suggest that the production and distribution capacity of the Japanese manufacturers is likely to permit a rapid increase in shipments. Also, these manufacturers are not likely to attempt to flood this market—even if it were possible.

(c) *U.S. law can prevent a flood.*—Present U.S. law—the "escape clause"—could, in a timely manner, impose a quota or other relief if a flood occurred and the domestic industry was injured. This is precisely the purpose of the escape clause—to prevent injury from increased imports—even if those imports are not dumped or subsidized.

(d) *Detroit can and will compete for the U.S. market.*—Detroit can and will compete effectively for its share of the U.S. market. Should Detroit face increased marketplace competition if the VA expires, it can take a number of actions in order to preserve or increase its sales and market share. First, Detroit can exercise wage restraint, as suggested by the U.S. Department of Commerce study. Second, in view of the fact that average car prices have increased substantially beyond the inflation rate and in view of the fact that Detroit's unit profitability is nearly double the 1975 level, it could exercise price restraint as well. This is likely to have the benefit of increasing demand for domestic cars, which in turn could increase employment. As Roger Smith, Chairman of General Motors, said in a January 30, 1985, Washington Post column, [43] Detroit is fully competitive in the automotive world.

In short, ending the VRA will restore competitive vigor to the U.S. auto market, for the benefit of the American consumer, the American economy and the American auto industry.

5. The overvalued dollar is the principal cause of the merchandise trade deficit and the elimination of our overall trade surplus in goods and services

Since the VRA can no longer be rationalized, supporters of the continuation of the VRA have attempted to justify VRA extension on the basis of the current merchandise trade deficit.

In response, it should be noted that the net flow of dollars to and from the United States is more significant than the balance of merchandise trade. This broader balance of trade in goods and services has been favorable to the United States in 33 of the past 38 years.

The recent elimination of this overall trade surplus is the result of factors other than automotive trade.

a. The budget deficit causes the trade deficit

The continuing and growing budget deficit has caused the overvaluation of the dollar which, in turn, has contributed to the trade deficit. The President's Economic Report,[44] notes this correlation:

> [o]ne of the most striking features of the present recovery in the United States is that it has been associated with a pronounced and persistent rise in the value of the dollar.
>
> Since 1980, the latest year in which the U.S. international current account was roughly in balance, the dollar has advanced steadily against a weighted average of other major currencies until by the end of 1984 it was about 65 percent above its 1980 average and at its highest level since flexible exchange rates were adopted in 1973. . . .

. This overvaluation of the dollar is the principal cause of the elimination of our overall trade surplus in goods and services. As U.S. Trade Representative Brock stated recently, the most important trade measure that Congress could take this year would be to reduce the budget deficit.

b. The strong dollar increases imports and decreases exports

The U.S. economic recovery has preceded, and been more robust than, that of our trading partners, resulting in the overvaluation of the dollar in comparison with Canadian, European, and Japanese currencies. According to the President's Economic Report,[45] there have been significant differences among the major industrialized

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[43] The Washington Post, January 30, 1985.
[44] The President's Economic Report, supra.
[45] *Id.*

countries, all of whom lagged behind the United States, in their recovery from the 1980–82 world recession. This retarded their ability to buy goods from us and resulted in an increase in low cost exports to the United States.

c. Third World countries' debts increase the trade deficit

The serious loan repayment problems of some of our trading partners have inhibited our exports to them. According to the President's Economic report.[46]

> [i]nitial improvements in the current accounts of borrowing countries were achieved primarily through cuts in imports. . . . As the leader in the global recovery, the United States with its comparatively open markets has played a disproportionate role in absorbing the output of the debtor countries.

d. The VRA may be strengthening the dollar and aggravating the trade deficit

The VRA may have acted to increase, rather than reduce, the merchandise trade deficit. The ITC concluded that "it is not clear whether the net effect of the VRA on the overall U.S. trade balance was positive or negative." While the ITC[47] found that [i]n the absence of the VRA, the U.S.-Japan trade deficit in automobiles would have been greater in 1983 and 1984, it recognizes that the effects of the VRA on the total trade deficit with Japan are not readily calculable owing to a variety of short run factors:

> To the extent that the VRA has increased the value of the dollar vis-a-vis the yen, it has resulted in reduced exports to Japan while leading to increased imports of items other than autos to the United States.
>
> To the degree the restriction has helped stimulate demand in the domestic auto industry and the aggregate U.S. economy, it has encouraged increased imports, both from Japan and other sources. Assuming that the VRA has induced Japanese auto manufacturers to locate in the United States, it has further tended to strengthen the dollar, leading to an even greater decline in exports and increases in imports. Because these indirect effects are not readily calculable, it is not clear whether the net effect of the VRA on the overall U.S. trade balance was positive or negative.

e. Trade with Japan is only part of the merchandise trade problem

While increasing in absolute terms, the merchandise trade deficit with Japan accounts for only 36% of the total deficit, and this has decreased from 57.3% of the total deficit in 1981. As pointed out in the President's Economic Report:[48]

> Emphasis on the bilateral balance in a multilateral trading system is misplaced . . . and can be misleading—just as would be inferences about a person's financial standing based on his or her relationship with only one creditor. In fact, the decline in the U.S. bilateral trade position with Japan since 1981 has been less than that with either the European Community or Latin America.

5. Conclusion

Mr. Chairman and members of the Subcommittee, the domestic automobile industry has clearly recovered and there is no conclusive evidence that the VRA has benefited the overall trade balance.

With the automobile industry enjoying record profits and American consumers paying record prices, AIA believes that the time has come to end automobile quotas and restore the benefits of competition in the markeplace.

APPENDIX 1

Members of Automobile Importers of America, Inc.: Alfa Romeo, BMW, Fiat, Honda, Isuzu, Jaguar, Lotus, Mazda, Mitsubishi, Nissan, Peugeot, Rolls-Royce, Saab-Scania, Subaru, Toyota, and Volvo.

Chairman GIBBONS. Now we will hear from Mr. McElwaine.

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[46] *Id.*
[47] ITC Preliminary Report, supra.
[48] The President's Economic Report, supra.

STATEMENT OF ROBERT M. McELWAINE, PRESIDENT, AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION, ACCOMPANIED BY STEVE HORVATH

Mr. McELWAINE. Mr. Chairman, I would like to continue the colloquy that the honorable gentleman from New York initiated earlier. As I understand Congressman Lundine's proposal, it is that Congress replace the expiring voluntary restraint agreement legislatively for a period of about a year while a committee composed of representatives of the Government, labor, and management study the situation.

We have had these quotas, Mr. Chairman, for 4 years now. During this period of time the consumers paid something like $16 billion in additional costs for automobiles. The domestic manufacturers have run up profits of $10 billion in the past year. It seemes to me that a more likely solution at this time might simply be to try the free enterprise system and see if it works.

I remember Mr. Roosevelt's famous statement that his philosophy was not that the system of free enterprise had failed in his generation, but that it had not yet been tried. I think that applies very well to this situation here. I think it is safe to say this: The end of the voluntary restraint agreement is not going to produce any great increase in Japanese imports sufficient to cause any injury to domestic industry.

Quite the contrary, I think it is going to cause a significant increase in the volume of sales of the Detroit manufacturers. The return of price competition, particularly at the low end of the market I think should materially increase Detroit's sales. I think it is already in evidence that the Detroit manufacturers are moving to become more competitive.

Ford Motor Co. announced last week a significant increase in the price of their large cars, and announced not only would they hold the price on the small cars, but subsidize the interest rates on those small cars, which works out to about a $500 price cut on their smaller cars. I am quite sure that that was in anticipation of the end of the VRA. The Chrysler Corp. is running these very large advertisements saying, "Thank you, America," and announcing a $500 price cut in the price of Chrysler products, and saying that financing and equipment savings are worth up to $1,000.

I think the Chrysler Corp. could have spread their thanks around a little more. They might have also thanked the Ministry of International Trade and Industry in Japan and the Japanese manufacturers for restraining their own competition in this market for 4 years to enable Chrysler to make this $1,200 profit per car they have been ringing up and give it back in the way of a price cut right now.

I do believe that these additional sales that the domestic manufacturers are going to make may well be at the expense of some of these profits that have been showing. That will not come as good news to the shareholders of the various companies, but it will certainly come as good news to the United Auto Workers who will find more jobs available in the industry, for the steel industry, the aluminum industry, the rubber industry, and supplier industries—

who really don't care how much money Detroit makes, but rather how many cars they may make.

I think we will see a significant increase in the number of cars produced. The automobile market has been underperforming in spite of these record profit levels. We have been vastly undereaching the projected volume that we should be reaching. For years it has been my job to anticipate market volume every year.

There is a certain system you follow. You use the scrappage rate, state of economy, interest rates, disposable income, age of the car population, and so forth, and you feed them all into your computer and come up with what your annual sales are going to be. Last year, the last 2 years, all those figures come up with 12 million cars a year. Last year we managed to achieve 10.4 million and everybody is celebrating, but we really undershot the market by nearly 2 million cars.

What happened there? What we had was a significant growth in the sale of large, luxury, high-priced cars and very little growth at the bottom end of the market. This doesn't really indicate that there is no market for that product, but what that indicates is there is no product for that market. There are approximately 2 million people who are ready and willing and able to buy a new car priced somewhere under $6,000.

These are the 2 million people who figuratively are standing with their noses pressed to the windows of our showroom floors, unable to afford or unwilling to afford the $13,000 per car that the average General Motors car now sells for. I think ending the quotas is going to correct that. It will end the vacuum that exists at the bottom end of the market right now, and it will bring 2 million people back into the market.

If the economy stays healthy through 1986, and quotas are not reimposed, I am quite sure we will reach a 12 million plus car year in 1986. Even if the Japanese take 2.5 million of that particular market—I don't think anyone is in a position to really complain because it will mean that the domestic manufacturers will be operating at capacity and that increase on the part of the Japanese will not represent a significant increase in their market share.

I think we need to examine some of the claims made by those who are opposing a free market, claims that the Japanese will now flood the U.S. market; claims made, for example, that in the absence of restraints the Japanese will take 40 percent of the U.S. market.

This means they are going to increase sales by 216 percent. It also would mean that small cars would have to take over 80 percent of the American market since the Japanese don't make anything larger than a compact and a majority of their cars fall into the subcompact classification.

I think such forecasts not only ignore the existing protections built into American law, built in against injury from imports, but are based on a distortion of statistics and sort of Malthusian projections. We have heard it said this morning that the Japanese manufacturers have an idle capacity of 2 million passenger cars and that all this capacity will be used to produce additional cars for the U.S. market.

Mr. Chairman, Mr. Horvath and I returned from Tokyo only Thursday of last week where we met with the Ministry of International Trade and Industry, with the Foreign Officer, and with the Japanese automobile manufacturers. The purpose of our trip was to examine the possible consequences of an end to the VRA.

According to our studies, we found the Japanese manufacturers currently producing at 90 percent of capacity which is roughly the same level the American producers are working at right now. What that means is that even if the Japanese were able to achieve a production miracle to reach 100 percent of productive capacity, they could increase their manufacturing by only 700,000 units a year including trucks, buses, and automobiles.

First, we have to realize that the United States only gets 25 percent of the cars that Japan produces. And to expect that we would get all 700,000 of those trucks, buses, and cars, I think is unrealistic. I would particularly note the statement made by the chairman of the Chrysler Corp., that as a consequence of the end of the VRA he would now move immediately to increase the importation of Mitsubishi vehicles by 200,000 units a year.

I think this is not calculated to set off any waves of joy or rejoicing among the Chrysler dealers. The last time I looked—this was in January—the Chrysler dealers were sitting on a 71-day supply of Mitsubishi cars. They are having great difficulty selling 87,000 of these cars a year. I wonder what they will do with 300,000.

Chairman GIBBONS. That is something I would not have noticed. I thought they were selling like hot cakes.

Mr. MCELWAINE. Import dealers sell them well. Those franchised by Mitsubishi are running a 16- to 20-day supply. Domestic car dealers seem to have less success at selling imported aubomobiles. As I say, the Chrysler dealers with a 71-day supply, have a quite substantial supply. That means you are carrying an inventory that is costing you a great deal at the bank for your floor plan money.

What it really comes down to is that the Japanese simply don't have the productive capacity, dealer organization, or the product mix, to achieve anything like the market penetration Detroit has warned against. They don't produce intermediate or large size cars, the category where sales are booming. And for all the perceived domination of the small car market by the Japanese, they are still out sold by domestically produced small cars at a 60-to-40 ratio.

Given a more competitive pricing structure, I don't think there is any reason to doubt that the U.S. companies are going to retain this market superiority without the crutch of the VRA. Very briefly, we should talk about the cost advantage because I know the witnesses last week talked continuously about the Japanese cost advantage, an alleged $1,600 cost advantage that they have.

They blamed it on the yen-dollar relationship. They blamed it on the Japanese tax structure. The fact is, Mr. Chairman, that the Japanese cars that are sold in this country carry a heavier tax burden than their domestic competition. The combination of taxes paid in this country, duties they pay, and taxes in their home countries are significantly greater than the taxes paid on cars by the U.S. manufacturers.

Chairman GIBBONS. Could you document that for us?

Mr. MCELWAINE. Yes, sir. We have a study done for us by Temple, Barker & Sloane in Boston, and we will happily submit that as a part of our testimony. It is very well documented in this study.

Chairman GIBBONS. Fine. I would ask the staff to examine that, and if it is not too voluminous, would it be possible for us to publish that in our record?

Mr. MCELWAINE. I think you could excerpt the section from the study, which is voluminous, and I can indicate the section that deals with that particular subject.

[The material referred to follows:]

[From "The Imported Automobile Industry in America," November 1984]

V. THE EFFECTS OF PROTECTIONISM

Automotive protectionism is a major American public policy issue. Proponents of protectionism maintain that high levels of import penetration in the U.S. automotive market deny needed flows of tax revenues for national, state, and local governments and diminish the number of jobs for American automotive employees.

Protectionist efforts tend to focus on one or both of the following measures and expected results:

Measure		Result
Decrease the availability of imported vehicles	⟶	Encourage consumers to purchase domestic vehicles
Increase the cost of imported vehicles	⟶	Allow domestic automakers to compete more effectively

In addition, either action could induce offshore producers to manufacture in the United States, thereby replacing foreign workers with American workers.

The imported automobile industry in America currently operates under both measures. The Japanese government's voluntary restraint on exports of passenger cars to the U.S. market has decreased the availability of Japanese automobiles by some 200,000 units (compared with the most recent year in which Japanese exports were not limited). In addition, the 25 percent duty on Japanese subcompact pickups has increased the price of these trucks by over $1,200.

Two additional protectionist proposals currently confront the Congress--one addresses "tax inequities," and the other imposes domestic content requirements. Through increased prices or decreased availability, both attempt to induce foreign makers to establish additional on-shore manufacturing operations. This chapter describes the two proposals and analyzes their probable success in producing the results desired by their advocates.

TAXES AND THE IMPORTED AUTOMOBILE

Advocates of automotive protectionism claim there are two types of tax inequities, or "unfairness," associated with the imported automobile industry:

- Vehicles manufactured offshore are taxed by their governments at a lower rate than that used by the U.S. government to tax vehicles manufactured in this country. As a result, imported vehicles have a "built-in" price advantage when sold in this country.

- The sale of an imported vehicle contributes fewer tax dollars to the American economy than does the sale of a comparable domestic car.

Tax Rates

The most notable advocates of the "unfair tax burden" premise--that is, the contention that Japanese-made vehicles carry a lower total proportion of direct taxes in their costs than do domestically made vehicles--have been John J. Nevin, Chairman of the Firestone Tire & Rubber Company, and Lee Iacocca, Chairman of the Chrysler Corporation.[10] Although Mr. Nevin and Mr. Iacocca disagree on amount, they believe that this presumed tax advantage has been translated directly into a price advantage for Japanese vehicles sold in the U.S. market. This, they claim, is why the various Japanese models have captured so much of the American market in the last 20 years. This premise appears unjustified.

Table 19 compares the total tax burden carried by the average Japanese and domestically produced vehicle sold in the United States.[11] The following types of taxes are generated by the production and wholesaling of each vehicle:

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[10] For example, see "Doorstop for Free Trade," Harvard Business Review, March/April 1983.

[11] The figures presented in Table 19 are based on five- or seven-year inflation-adjusted weighted averages to take into account the cyclical nature of the automotive industry. In addition, wherever possible, the assumptions and guidelines used in deriving the figures have been made so as to potentially overstate the domestic tax contributions. For example, the domestic figures were calculated from a weighted average of General Motors and Ford data; financial data from Chrysler were not used, as several years of substantial losses during the study period resulted in tax credits rather than tax payments.

- Wholesale Distribution: Income, payroll, property, and other taxes paid by the companies or subsidiaries of the companies that import and/or distribute passenger cars and light trucks.

- Import Duties: Tariffs, or import taxes, levied by the federal government on parts and vehicles imported into the United States. (Many domestically produced vehicles contain significant amounts of imported parts. The exact data are not revealed by the domestic manufacturers.)

- OE Manufacturing Income: National and subnational taxes on income paid by the companies that complete the assembly of the vehicle.

- OE Manufacturing Other: Nonincome taxes (payroll, property, etc.) paid by the companies that complete the assembly of the vehicle.

- Supplier Income: National and subnational taxes on income paid by the companies that provide parts and component systems to the OE manufacturers.

- Supplier Other: Nonincome taxes (payroll, property, etc.) paid by the companies that provide parts and component systems to the OE manufacturers.

In summary, the average domestic vehicle, wholesaling at approximately $10,247, carries to the market a tax burden of 9.2 percent (or roughly $943). In contrast, the average Japanese vehicle sold in this country carries a tax burden of 13.8 percent ($1,004 on a wholesale price of $7,292).

Mr. Nevin, Mr. Iacocca, and others have also made mention of the Japanese commodity tax as a source of unfair advantage. This domestic consumer tax, similar to state or local sales taxes in the United States and value-added taxes in Europe, is assessed when a vehicle is sold in Japan. It is not, therefore, assessed on vehicles produced in Japan and exported to the United States, where a state or local sales tax may then be assessed on the vehicle. As a result, rather than providing an advantage for Japanese vehicle manufacturers, this commodity plays no role at all in the tax burden carried by an imported Japanese vehicle sold in this country or any other country.

Table 19

DOMESTIC AND IMPORTED MOTOR VEHICLE TAXES: SUMMARY

($ per vehicle)

	Domestic	Japanese Import
Wholesale Distribution	*	$ 150
Import Duty	N.A.	$ 330
OE Manufacturer:		
Income Taxes	$ 182	$ 193
Other Taxes	$ 344	$ 54
Related Suppliers:		
Income Taxes	$ 126	$ 170
Other Taxes	$ 291	$ 107
Total Tax Burden	$ 943	$1,004
Estimated Average Wholesale Value per Vehicle	$10,247	$7,292
Total Tax Burden as a Percent of Vehicle Value	9.2%	13.8%

* Included in OE manufacturing.
N.A. = Not available.

Source: TBS research; corporate annual reports.

Tax Contributions

Mr. Nevin and Mr. Iacocca have also been advocates of the premise that imported vehicles pay fewer taxes to the country where they are sold than do comparable domestically produced vehicles. They are, of course, correct. This is true of all types of imports--not just automobiles--and all countries, not just the United States. For example, the $371 million worth of tires exported by Mr. Nevin's industry in 1982 probably contribute less in direct taxes to the importing countries than do tires actually manufactured in those importing countries.

However, according to Mr. Nevin and Mr. Iacocca, the sale of each imported Japanese vehicle contributes only $250 in taxes to the American economy. Table 20 presents a detailed review of the tax contributions generated by the sale of each imported vehicle in the United States. In 1982, these contributions topped $1,180 per unit, or more than four times the contribution claimed by Mr. Nevin and Mr. Iacocca.

Table 20

TAXES PAID PER IMPORTED VEHICLE

1980-1982

	1980	1981	1982
Importer Taxes (millions)			
Income Taxes	$248.1	$295.4	$388.5
Payroll Taxes	31.9	39.9	38.4
Other Taxes	28.4	28.8	32.0
Duties	482.3	849.0	847.7
Total Importer Taxes	$790.7	$1,215.8	$1,306.6
Employee Taxes			
Importer Employees	23,304	23,139	20,445
Importer Compensation (millions)	$491.1	$559.5	$516.3
Average Wage per Employee	$21,073	$24,180	$25,253
Total Employee Taxes (millions)[1]	$119.3	$136.0	$125.4
Total Dealer-Related Taxes	$1,219.2	$1,171.7	$1,287.6
Total Port/Supplier Employee Taxes (millions)[1]	$116.9	$141.3	$163.0
Total Taxes Paid (millions)	$2,246.1	$2,664.8	$2,882.6
Total Vehicles Sold[2]	2,458,117	2,471,507	2,441,312
Total Taxes per Vehicle	$914	$1,078	$1,181

[1]Total employee compensation times effective employee tax rate for average wage level; includes federal, state, and local income taxes and social security taxes.

[2]Noncaptive imported passenger cars and class 1 and 2 trucks.

Source: Ward's Automotive Yearbook; IBS research.

The Proposal

Mr. Nevin and Mr. Iacocca are calling for the U.S. government to take some action regarding these "tax inequities." Mr. Nevin has specifically proposed that Congress raise the tariff, or duty, on imported cars from 2.8 percent to 20.0 percent. He acknowledges that such an action might violate the international trade agreements of the United States and therefore suggests an alternative: Congress should enact a 17.5 percent minimum excise tax on all automobiles sold in the United States. This tax (paid by the auto consumer) would be rebated to domestic manufacturers but not to offshore manufacturers. Mr. Nevin argues that in both proposals the resulting price increase in imported vehicles would make consumers look to domestic models for their next purchase.

Would It Actually Work?

Would a significant price increase in imported vehicles make domestic makers more competitive, thereby encouraging more Americans to buy domestic vehicles and creating a substantial increase in U.S. tax collections?

One concrete example of such a price increase exists: the application of the 25 percent duty on light commercial vehicles to Japanese small pickup trucks in May 1980. This duty (similar to Mr. Nevin's suggestion) resulted in an immediate 23.4 percent increase (roughly $1,200) in the price of these small trucks. Since May 1980, the duty has also had the following effect:

- Prices of branded imported small pickups have risen, on average, over 25 percent.
- Branded imported pickups have increased their share of the Class 1 (GVW $\leq$6,000 lbs.) truck market--from 19 percent to 26.2 percent.
- Unit sales of branded imported pickups have increased 19 percent per year.
- Under the umbrella of the $1,200 increase in the average price of imported pickups, domestic manufacturers launched their own small pickup models, such as the Ford Ranger and the Chevy S-10. These domestic pickups were introduced to the market at prices equivalent to those of the branded imported trucks.

- Domestic pickups have increased their share of the Class 1 truck market from 68.5 percent to 70.7 percent.

- Sales of Class 1 captive imported trucks have dropped from over 225,000 units per year to under 95,000 units per year.[12] The Ford Courier and the Chevy LUV have been completely replaced by domestic models.

To summarize: a significant increase in the price of imported trucks has

- Allowed domestic manufacturers to replace captive models with domestically produced models priced as high as the imports,

- Not stopped consumers from buying branded Japanese small trucks at ever-increasing prices, and

- Made consumers pay $1,200 more for small trucks.

Would the effect of a price increase applied to passenger cars be the same? The most significant difference would be in the area of captive imports. Unlike the small truck market when the 25 percent duty was imposed, captive passenger car imports account for only a small percentage of the U.S. new car market. Therefore, domestic manufacturers would not be able to supplant these captives with their own models. Instead, consumers would continue to purchase branded imported automobiles at higher prices.

DOMESTIC CONTENT LEGISLATION

The other major protectionist initiative currently before the Congress proposes to provide jobs for American automotive workers through domestic content requirements. An automotive domestic content law requires that a specified percentage of the value of an automobile be provided to the country where the automobile is sold. For example, H.R. 1234 (the bill passed by the House in 1983) imposes a requirement of 25 percent local content on sellers of 250,000 vehicles, 50 percent on sellers of 500,000 vehicles, and at least 90 percent on sellers of more than 900,000 vehicles by model year 1986. (Importers selling less than 100,000 vehicles would be exempt.)

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[12] Ward's Automotive Reports.

Domestic content requirements are generally established by developing countries like Mexico and Brazil to foster and protect "infant" automobile industries. Domestic content requirements have also been used by smaller industrialized countries (like Australia and South Africa) whose markets are not large enough to support fully economical auto industries, but who have decided that their automotive consumers should bear the extra cost of maintaining such industries. No country with an auto industry the size and sophistication of the American auto industry ever imposed domestic content requirements.

The Effects of Domestic Content Legislation

Estimates of the employment effects of a domestic content law vary widely:

- The UAW, the primary supporter of H.R. 1234, claims that the bill would create more than 700,000 jobs.
- The Congressional Budget Office estimates that the passage of H.R. 1234 would actually result in the loss of 66,000 jobs.
- Chase Econometrics claims that 390,000 Americans would be put out of work owing to trade retaliation following the passage of H.R. 1234.
- The U.S. Department of Transportation and the U.S. Department of Commerce both predict that between 50,000 and 100,000 jobs would be lost.
- The Heritage Foundation predicts that 90,000 port jobs and 80,000 dealer jobs would be lost.

Adverse economic effects are also expected. The Department of Commerce estimates that the price of the average car sold in the United States (big or small) would increase by $450. The Heritage Foundation predicts a $500-$1,000 increase per car, and the Congressional Budget Office estimates a $333 increase per car.

Furthermore, opponents of a domestic content law claim that its passage would restrict the ability of existing domestic makers to buy parts--and imported cars--from offshore components suppliers and automakers. Such purchases are being used by all domestic manufacturers to broaden their product lines with specialty vehicles, remain cost competitive with import makers, and avoid additional capital investment (which has been at record

levels). Tables 21 and 22 illustrate the importance of these purchases to domestic makers.

Table 21

FOREIGN SOURCING

Partial List of 1977-1981 Commitments by Major Domestic Auto Manufacturers to Purchase Foreign-Made Vehicles and Components for Use as or on Domestic Nameplate Vehicles

	Purchase	Source	Number
General Motors	2.8 liter V-6 engines	GM de Mexico	400,000/yr
	2.0 liter L-4 engines and transmissions	Isuzu (Japan)	100,000/yr
	1.8 liter L-4 engines	GM de Brazil	250,000/yr
	THM 180 automatic transmissions	GM (France)	250,000/yr
	Manual transmissions	Isuzu	250,000/yr
Ford	2.2 liter L-4 engines	Ford--Mexico	400,000/yr
	Diesel L-4 engine	Toyo Kogyo (Japan)	150,000/yr
	Manual transaxles	Toyo Kogyo	100,000/yr
	Ball joints	Musashi Seimibu	1,000,000/yr
Chrysler	L-6 and V-8 engines	Chrysler de Mexico	100,000/yr
	2.2 liter L-4 engines	Chrysler de Mexico	270,000/yr
	2.6 liter L-4 engines	Mitsubishi	1,000,000
	1.7 liter L-4 engines	Volkswagen	1,200,000
	Manual transmissions	Volkswagen	500,000
	1.6 liter L-4 engines	Talbot (France)	400,000
	2.0 liter Diesel V-6	Peugeot (France)	100,000/yr
	1.4 liter L-4 engines	Mitsubishi	300,000/yr
	Aluminum cylinder heads	Fiat (Italy)	N.A.
	CV joints	Peugeot	400,000/yr
	CV joints	GKN (England)	N.A.
	A/C compressor units	Sankyo Electric	400,000
	Dodge/Plymouth Colt Cars	Mitsubishi	84,000/yr
	Dodge 50 Ram trucks	Mitsubishi	40,000/yr
AMC	Car components and power train	Renault	500,000/yr

N.A. = Not available.

Source: Ward's Automotive Yearbook; Automotive News; Ward's Engine Update; American Metal Market; Detroit Free Press; Japan Economic Journal; Detroit News.

Table 22

ESTIMATE OF CHRYSLER'S 1982 LEVEL OF DOMESTIC CONTENT

1982 Sales	
Chrisler/Plymouth cars	691,703
Mitsubishi captive imported cars	102,227
Mitsubishi captive imported trucks	40,006
Total	833,936
Level of Domestic Content Required under H.R. 1234:	83.4%
Average Value of Mitsubishi Imports:	$5,500
Average Value of Domestic Sales:	$8,000
Total Dollar Content of Sales:	$6.3 billion
Foreign Content (major components only)	
Mitsubishi cars and trucks	$782 million
Engines	$281 million
Transmissions	$100 million
Estimated Local Content:	81.5%

Source: Ward's Automotive Yearbook, 1983; Business Week; TBS research.

To determine if the passage of a domestic content bill like H.R. 1234 would significantly add to domestic sales--and hence domestic employment--we considered two possible outcomes:

(1) H.R. 1234 is made law, and none of the most seriously affected offshore makers chooses to set up additional domestic manufacturing facilities. (Several of the offshore companies have stated that this will be the case.)

(2) H.R. 1234 is made law, and offshore makers do make further investments in domestic manufacturing facilities.

(1) Net Employment Effect of Limited Availability

The first outcome, which would result in decreased availability of imported vehicles, is examined in the following questions.

- How many fewer imported vehicles would be available to the American public?

Under the specific terms of H.R. 1234, every manufacturer who sells over 100,000 cars in the domestic market must satisfy a certain level of domestic content. On the basis of 1982 sales figures, five import makers--Toyota, Nissan, Honda, Toyo Kogyo (Mazda), and Fuji Heavy Industries (Subaru)--would be affected.

If none of these manufacturers chose to build additional domestic facilities--Honda already has an auto assembly plant in Ohio, and Nissan has a truck facility in Tennessee--each would have to reduce the number of vehicles it sells in the United States. Table 23 details the effect of this choice. The number of vehicles imported to the United States would drop slightly over 1.2 million units (or 46 percent) from 1982 levels.

Table 23

EFFECT OF DOMESTIC CONTENT LEGISLATION ON IMPORTED CAR VOLUMES

	1982 Car and Truck Sales	Limit Under H.R. 1234	Units Lost
Toyota	674,554	100,000	574,554
Nissan	578,173	205,000[a]	373,173
Honda	365,865	255,000[b]	110,865
Mazda	204,679	100,000	104,679
Subaru	150,335	100,000	50,335
Total	1,973,606	760,000	1,213,606

[a]Nissan limit is based on 50 percent level content and planned 1984 Smyrna production of 84,000 trucks.

[b]Honda limit is based on 50 percent local content and planned 1984 Marysville production of 130,000 Accords.

- How many additional domestic vehicles would be produced?

In May 1981, the Japanese government agreed to voluntarily limit exports to the United States. During the first six months of 1981, imported automobiles from Japan and Europe accounted for 30.2 percent of all new cars sold--on average, 211,893 of the 701,030 units sold per month.

During the six months ending October 1983, new car sales averaged over 806,000 units per month, with imports accounting for 25.4 percent, or 204,963 units per month.[13] However, demand for Japanese passenger cars was so strong that inventories during that period were around 20 days' supply, compared with the 40-60 days' supply for the leading domestic subcompact. If we assume that without the quota, imports would have still accounted for 30.2 percent of the market (or roughly 243,000 units month), the data suggest a loss of 39,000 import sales month.

From May to October 1983, sales of domestic subcompacts, cars that compete most directly with the imports, were running only 32,000 units per month above the first six months of 1981. Thus, it seems that some buyers were still waiting for imports rather than substituting domestic subcompacts, a hypothesis that the inventory figures bear out.

Rather than predict the buying behavior of the American public during import shortages, for the purposes of this analysis we have assumed that every one of the 1.2 million lost sales in imports would be replaced by domestically manufactured vehicles.

- How many jobs would be gained in domestic manufacturing?

The addition of 1.2 million units to domestic production would certainly have an incremental effect on domestic employment. Table 24 summarizes the effect on auto employment of previous comparable increases in production. The table suggests that 3.65 manufacturing jobs are created for every 100-unit increase in production. Therefore, it is likely that an increase in production of 1.2 million units would create an additional 44,296 manufacturing jobs in American auto factories.

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[13] Ward's Automotive Reports.

Table 24

GAINS IN DOMESTIC MANUFACTURING EMPLOYMENT
ASSOCIATED WITH LARGE INCREASES IN VOLUME

	Car Production[1]	Truck Production[2]	Total Employment[3]	Incremental Vehicles	Incremental Jobs	Incremental Jobs per 100 Incremental Vehicles
1977	9,293,674	3,433,569	938,000	1,243,074	57,000	4.58
1976	8,537,759	2,946,410	881,000	2,493,078	89,000	3.57
1975	6,740,584	1,946,489	792,000	-	-	-
1973	9,667,118	3,007,495	944,500	1,375,377	81,700	3.94
1972	8,827,706	2,471,530	862,800	-	-	-
1971	8,537,878	2,053,146	842,600	2,368,507	45,300	1.91
1970	6,550,077	1,692,440	797,300	-	-	-
				7,480,036	273,000	3.65

[1] Automotive News Market Data Book.
[2] 1970-1971 factory sales; 1972-1977 production; Automotive News Market Data Book.
[3] Automotive News Almanac Issue, 1975; U.S. Department of Labor (SIC 371).

According to the Department of Labor, each additional 100 jobs in vehicle manufacturing creates 105 jobs in related supplier industries.[14] Adjusting for those jobs that are not typically as volume sensitive (e.g., finance), it is likely that each additional 100 jobs in vehicle manufacturing would result in an additional 65.3 supplier-related jobs.[15] Thus, the 44,296 incremental assembly jobs would also result in another 28,925 supplier jobs. In total, approximately 73,200 new jobs would be created in domestic manufacturing.

[14] Direct Supplier Industry Labor Requirements (Jobs per 100 Jobs in SIC Classification 371--Motor Vehicles and Motor Vehicle Equipment), U.S. Department of Labor, Bureau of Labor Statistics, as exhibited in O'Donnell and MacLennan, The Effects of the Automotive Transition on Employment: A Plant and Community Study, U.S. Department of Transportation, December 1980.

[15] According to the 1982 Harbridge House study Domestic Content Legislation: A Tax on the American Consumer, 39.7 of the 105 jobs in related supplier industries would not be affected by a shift in production since they relate to transportation (7.1 jobs), finance (2.2), wholesale and retail trade (10.2), and "service and other" (20.2).

- How many jobs would be gained in domestic dealerships?

Selling an additional 1.2 million domestically manufactured vehicles is also likely to generate additional employment in automobile dealerships. Table 25 shows five years where retail sales of cars and light trucks increased by at least one million units in the period of one year; the impact varied widely from year to year, in one instance even decreasing. However, the data suggest that, on average, an additional 100 units moving through a retail dealership creates 1.05 new jobs. Consequently, for an increase of 1.2 million units, approximately 12,742 new dealer jobs would be created.

Table 25

GAINS IN DEALER EMPLOYMENT ASSOCIATED WITH LARGE INCREASES IN REGISTRATIONS

	Car Registrations[1]	Truck Registrations[1]	Dealer Employment[2]	Incremental Registration	Incremental Jobs	Incremental Jobs per 100 Incremental Vehicles
1977	10,826,234	3,509,328	765,200	1,526,068	23,300	1.526
1976	9,751,485	3,058,009	741,900	2,150,237	23,500	1.092
1975	8,261,840	2,397,417	718,400	-	-	-
1973	11,350,995	3,029,074	778,000	1,378,323	10,000	0.725
1972	10,487,794	2,513,952	768,000	1,177,934	39,000	3.310
1971	9,830,626	1,993,186	729,000	1,645,631	(13,000)	(0.79)
1970	8,388,204	1,790,177	742,000	-	-	-
				7,877,993	82,800	1.051

[1]Ward's Automotive Yearbook.
[2]National Automobile Dealers Association, NADA Data for 1979.

- How many jobs would be lost in domestic distribution?

Import dealerships would certainly suffer a loss of employment if they were to sell 1.2 million fewer vehicles. In fact, the loss would be considerably greater than the gain in employment in domestic dealerships. Why would the loss not be exactly offset by the jobs gained in domestic dealerships?

The reason lies in the magnitude and direction of the change in sales volume. Domestic dealers, each perhaps selling only another 60 to 70 cars per year, could absorb much of the extra

volume with existing personnel. This is particularly true now when many dealerships are selling below traditional volumes. Moreover, domestic dealerships could probably handle the extra volume without adding incremental nonsales personnel, e.g., parts, service, and administrative employees.

On the other hand, the large decreases in volume at import dealerships would result in dealers being forced to close their businesses completely. In turn, dealer closings would affect parts, service, administrative, and sales personnel alike, throwing all out of work.

Experience with large percentage decreases in volume confirms this line of reasoning. Table 26 details the effect on seven domestic and import dealer bodies of volume declines greater than 30 percent over a five-year period (after 1973). On average, slightly more than one dealer is forced to close for every 1,000-unit decline in sales. Given the 1982 NADA average figure of 28 employees per dealership,[16] 3.21 jobs are lost through closings for every 100-unit decrease in sales. This contrasts with the creation of 1.05 jobs for every 100-unit increase in sales (discussed above).

Table 26

DEALERSHIP CLOSINGS ASSOCIATED WITH LARGE DECREASES IN SALES VOLUME

1974-1982

Make	Period	Percent Sales Decline	Unit Decline	Dealership Closings	Dealer Closings per 1,000-Unit Sales Decline
Volkswagen	1977-1982	44.9%	145,291	62	0.4326
Fiat	1976-1981	47.6	31,068	175	5.5684
AMC	1974-1979	50.8	167,374	209	1.2487
	1975-1980	53.6	172,834	155	0.8968
	1976-1981	44.8	110,958	146	1.3158
	1977-1982	39.0	71,928	83	1.1539
Chrysler	1975-1980	33.8	337,099	869	2.5778
	1977-1982	43.3	528,049	1,156	2.1892
Jaguar	1975-1980	56.6	3,848	33	8.5758
	1976-1981	56.5	2,694	45	16.7037
Ford	1976-1981	37.9	842,000	816	0.9691
	1977-1982	47.2	1,160,000	1,091	0.9405
GM	1977-1982	32.0	1,607,000	1,235	0.7672
			5,178,143	6,071	1.1724

Source: Automotive News Market Data Book.

[16] National Automobile Dealers Association, Facts and Figures, 1983, page 11.

Table 27 shows the number of dealer closings resulting from the passage of a domestic content bill similar to H.R. 1234. Multiplying each figure by the appropriate average number of employees per dealership (which ranged from 11.8 to 28.4 for the five dealer bodies), we estimated that approximately 35,227 import dealership jobs would be lost. The negative employment effect would be even greater if not for import-domestic dual dealerships.

The loss of 1.2 million units is also likely to result in a reduction in importer employment. The 35,227 dealer jobs lost (detailed above) represent 36.5 percent of the total dealership employment of the five makers targeted by the domestic content bill. If importer employment is reduced by an equal percentage,

Table 27

DEALERSHIP CLOSINGS RESULTING
FROM DOMESTIC CONTENT LEGISLATION

Importer	Unit Decline	Percent Sales Decline	Dealership Closings
Toyota	574,554	85.0%	673
Nissan	373,173	64.5	437
Honda	110,865	30.0	130
Mazda	104,679	51.0	122
Subaru	50,335	33.0	59
			1,421

Source: TBS research.

another 2,243 jobs would be lost. Overall, for the five makers affected, employment would be reduced 36.5 percent, following a sales decline of 61 percent.

- How many jobs would be lost in domestic manufacturing?

In 1982, five offshore makers--Toyota, Nissan, Honda, Mazda, and Subaru--accounted for 75.0 percent of all the imported vehicles sold in the United States; their sales would be reduced by 61 percent if H.R. 1234 were passed. This reduction would probably be reflected in cutbacks in the domestic parts and components orders placed by these manufacturers. If these cutbacks equal 61 percent of the five makers' orders (a reduction 46 percent overall), approximately 6,125 jobs in domestic manufacturing would be lost.

- How many port jobs would be lost?

Port service jobs associated with imported vehicles are strongly correlated with the number of units passing through the ports. A drop of 1.2 million in these units (or 46 percent) translates into the loss of approximately 5,175 of the 11,250 port service jobs dependent on imported vehicles.

- What is the net employment effect?

The effect on employment of the passage of a domestic content law similar to H.R. 1234 (where the import makers do not come onshore) is a net gain of approximately 37,172 auto and auto-related jobs:

	Domestic Employment Gain	Domestic Employment Loss
Manufacturing	73,200	6,125
Importing and Distribution	-	2,243
Dealerships	12,742	35,227
Ports		5,175
Total	85,942	48,770

- What is the cost of creating 37,172 jobs?

The limited availability of popular Japanese models following the announcement of the voluntary export restraint agreement resulted in a significant increase in the price of these models. According to a recent study, this increase amounted to $3,200 per car.[17] Some components of the price increase are described below:

Increased Importer Profit. Limited in the number of vehicles they could export to the United States, Japanese makers raised the prices on popular import models to help maintain profit levels. Domestic prices of popular Japanese imports rose $198 more than the prices of the same cars in the highly competitive Japanese home market.

[17] Domestic Content Legislation: A Tax on the American Automobile Consumer, Harbridge House, Inc., July 1982.

Product Mix. Also to help maintain profit levels, Japanese makers began adding more options to their vehicles and exporting proportionally more of their larger cars (known as "upscaling" the product line). As a result, consumers have been paying approximately $734 more for the average Japanese car.

Currency Fluctuation. Since the quota was established in 1981, the yen has weakened against the dollar. Limited by the number of cars they could sell in the United States, Japanese manufacturers have chosen to keep their dollar price in line with domestic models, rather than use all or part of the exchange fluctuation to lower prices (against the dollar), and fight for greater market share among themselves (as they might in a competitive marketplace). Therefore, the quota has resulted in consumers' paying an average of $957 more per car.

These costs were caused by only a 7 percent decrease in import availability; the passage of a bill like H.R. 1234 could decrease import availability by 46 percent.

In addition, past history shows that domestic makers will take advantage of any price increase in imported models to increase their own prices. Support for this assertion comes from the light truck market, where domestic makers didn't even make small pickups until prices--driven by the 25 percent duty--went up roughly $1,200. The domestic makers then introduced their own models at prices comparable to the Japanese trucks, even though the domestic models paid no duty. Moreover, pressure for increases in domestic prices is evident in a recent statement made by the Ford Motor Company, where Ford admits that it loses $500-$700 on each Escort it sells.

What costs would result from the passage of a domestic content bill such as H.R. 1234? Even with a stable yen-dollar relationship, import makers would be encouraged to continue to upscale and add slight increases in manufacturer profit to offset the lower volume of sales. At a minimum, the 760,000 units (from the five leading importers) that could still be sold in the domestic market would cost another $1,000 each.

Domestic makers could then take advantage of this increase to achieve profitability in their small models. A $1,000 price increase would just erase the $500-$700 now being lost on each model plus add a 6 percent pretax profit--roughly GM's margin in 1983.

The $1,000 increase would apply as follows:

To all domestic subcompacts now produced at a loss (1.35 million in 1982)

To all additional domestic subcompacts produced in place of lost imports (1.2 million)

To the remaining imports of the five leading Japanese makers (760,000)

Moreover, it is entirely possible that other manufacturers dealers might take advantage of a "shortage mentality" to raise prices for other models as well.

At a minimum, 3.3 million American consumers would pay $3.3 billion to create 37,172 new auto and auto-related jobs--a cost of almost $90,000 per job. According to the Ford Company's 1982 Annual Report, a typical employee receives a salary of $27,140 (assuming 2,000 hours per year) plus benefits of another $19,600 per year, or a total of $46,470. The remaining $42,575 per job, or $1.6 billion, would be spread among domestic manufacturers (already at near-record profit levels),[18] the surviving import dealers, and offshore manufacturers.

(2) Net Employment Effect of New Onshore Investment

A similar process can be followed to examine the second possible outcome of the passage of a domestic content bill: the major offshore makers choose to construct additional assembly facilities in the United States.

- How many offshore makers would build plants?

Although no one knows the answer to this question--including the offshore makers themselves--we have assumed that each of the five leading makers would attempt to maintain its current unit sales level. Table 28 details the number of vehicles that each maker would have to manufacture in the United States, at 100 percent local content, to satisfy this assumption.

[18] Automotive News, July 18, 1983, page 3.

Table 28

EFFECT OF DOMESTIC CONTENT LEGISLATION
ON IMPORTED CAR VOLUMES

	1982 Sales	Percent Domestic Content Required Under H.R. 1234	Current Domestic Production	Domestic Production Required to Satisfy H.R. 1234[a]	New Domestic Production	Units Imported	Lost Imports
Toyota	674,554	67.4%	-	455,000	455,000	219,554	455,000
Nissan	578,173	57.8	84,000	335,000	251,000	243,173	251,000
Honda	365,865	36.5	130,000	135,000	5,000	230,865	5,000
Mazda	204,679	20.4	-	40,000[b]	-[b]	100,000	104,679
Subaru	150,335	15.3	-	25,000[b]	-[b]	100,000	50,335
(Domestic)	-	-	-	-	155,014[c]	-	-
Total	1,973,606		214,000	990,000	866,014	893,592	866,014

[a]Assumes that all domestically produced vehicles are 100 percent local content.
[b]Volume too small for economical domestic production.
[c]Equals lost Mazda and Subaru production.

In summary, the successful implementation of a bill like H.R. 1234 could result in a total of 866,014 new domestically manufactured vehicles: 711,000 in new or existing plants belonging to offshore makers and the remainder in new or existing plants belonging to domestic manufacturers. Based on 1982 volumes, 1.77 million vehicles would still be imported, which represents a drop of 33 percent.

- How many jobs would be gained in domestic manufacturing?

To assess the number of new manufacturing jobs created under this scenario, we can turn to the figures previously developed, i.e., for every 100 incremental units produced, 3.65 new jobs would be created in vehicle manufacturing. (One might argue that since new [not established] plants would be involved, this number should be raised to take into account new management and other support personnel. However, this increase would probably be offset by the fewer workers per unit of output required by newer plants--a result of higher levels of automation and newer equipment.)

Under this assumption, then, the 866,014 new units would result in 31,610 new vehicle manufacturing jobs. As before, we have assumed that for each of these jobs 0.653 supplier jobs would be created, bringing the total incremental manufacturing employment figure to 52,251.

- How many jobs would be gained in domestic dealerships?

The 711,000 units produced by the offshore manufacturers in their new onshore facilities would still be sold through existing imported auto and truck dealer channels. The only incremental effect would be the result of the 155,014 units added to the domestic makers' total production. As before, data indicate that for every 100 incremental units sold, 1.05 dealership jobs would be created--which would amount to 1,627 jobs.

- How many jobs would be lost in domestic distribution?

The transfer of 155,014 units from Mazda and Subaru dealerships to domestic dealerships would result in dealer closings in both the Mazda and Subaru dealer bodies. Our estimate, based on the same methodology used above, is that 2,392 dealership jobs would be lost. On a pro rated basis, an additional 156 jobs would be lost at the importer and distributor level.

- How many jobs would be lost in domestic manufacturing?

Based on our estimate of 13,325 supplier jobs associated with offshore manufacturing and parts requirements, a drop in import volume of 33 percent would result in a loss of 4,400 jobs in domestic manufacturing.

- How many port jobs would be lost?

Based on our estimate of 11,250 port jobs associated with the unloading and make-ready of imported vehicles, a drop in import volume of 33 percent would result in the loss of 3,712 port jobs.

- What is the net employment effect?

The effect on employment of the passage of a domestic content law similar to H.R. 1234 (where the import makers agree to come onshore) is a net gain of approximately 43,218 auto and auto-related jobs:

	Domestic Employment Gain	Domestic Employment Loss
Manufacturing	52,251	4,400
Importing and Distribution	-	156
Dealerships	1,627	2,392
Ports	-	3,712
Total	53,878	10,660

- What is the cost of creating 43,218 jobs?

There is general agreement in the automotive industry that it is more expensive to build a small car in the United States than in many offshore plants, including Japanese plants. If vehicles built in the new domestic facilities carry a $1,000 price increase to cover this extra expense, and the price of imported vehicles rises by a similar amount (through upscaling and profit taking), American consumers would pay an extra $1,000 for the following:

The 1.35 million subcompacts currently manufactured in the United States (for manufacturing penalty)

The 866,014 new domestic small cars (also for manufacturing penalty)

The 893,952 units still imported by the five leading Japanese makers (for upscaling and profits)

In sum, 3.1 million American consumers would pay $3.1 billion to create 43,218 new jobs--a cost of almost $75,000 per job. As before, $46,470 of this amount would go to new auto and auto-related employees. The remainder, $1.1 billion, would go to the domestic and offshore vehicle manufacturers.

Chairman GIBBONS. For the record now, would you repeat what you just told me about that?

Mr. MCELWAINE. The tax burden on a Japanese automobile sold in the United States is heavier than the tax burden on a U.S. car sold in this market.

Chairman GIBBONS. That certainly flies against the popular notion around here.

Mr. MCELWAINE. I know it does, sir, and that is probably why we received such cries of anguish from the Chrysler Corp.—from the Chrysler people when we announced this.

Chairman GIBBONS. Chrysler admits it hasn't paid taxes in a long time because of failure to make a profit.

Mr. MCELWAINE. That is an interesting study, sir. Duties paid to the U.S. Government on the importation of Japanese cars in 1984 were more than double the total corporate income taxes paid by the Chrysler Corp. for 15 years.

Chairman GIBBONS. What was that?

Mr. MCELWAINE. More duties were paid to the United States in duties in 1984 on Japanese imports than the Chrysler Corp.'s income tax payments for the past 15 years. In fact, it was more than double all they have paid in 15 years.

Chairman GIBBONS. I assume you can get that out of the public records?

Mr. MCELWAINE. Yes, sir.

Chairman GIBBONS. Without looking at the Chrysler's tax returns?

Mr. MCELWAINE. The testimony was given by a Chrysler witness in a world court, World Trade Court trial in New York recently. The final cost advantage story which is repeated is that the yen-dollar relationship is responsible for a $900 cost differential. That was pretty well destroyed by economist Martin Anderson, in a MIT study on which they spent 4 years, in which they pointed out that the allegation that there is a $900 cost advantage because of the yen-dollar relationship is based on taking 20 percent of the retail price of a Japanese car saying that that represents 20 percent as an imbalance in the yen-dollar relationship.

Mr. Anderson correctly points out that that $8,000 represents $1,200 in American dealer profits, $800 in American distributor profits—which is all in dollars—several hundred dollars in transportation costs and he goes on through it. Japan also pays for all its energy costs in dollars.

It pays for most of its raw materials in dollars. And the yen-dollar relationship finally worked out to about a $200 or $300 cost advantage to the Japanese which is more than swallowed up by duties and transportation charges on the same car.

The truth is that if the Japanese have a cost advantage, it seems to be largely a willingness to take a lower profit level on the cars they sell. In 1984, for example, the Toyota company sold 3.4 million automobiles worldwide, and they reported a net profit of $1 billion. Nissan sold 2.5 million automobiles and reported a net profit of $315 million. The Mazda Corp. sold 1.34 million automobiles and reported a net profit of $121 million. That works out to $313 a car profit for Toyota, $126 a car profit for Nissan, and $90 a car profit for Mazda.

Chrysler declared net profits of $2.4 billion on the sale of 2 million cars, for an average profit per car of $1,200; more than $1,000 a car larger profit than the Nissan Corporation is making.

Chairman GIBBONS. Give me that one again. These figures come kind of fast. I want to be sure they are not misheard.

Mr. MCELWAINE. Chrysler Corp. sold 2 million cars in 1984.

Chairman GIBBONS. Got you.

Mr. MCELWAINE. That is a little more than half of what the Toyota Corp. sold. Chrysler Corp. made $2.4 billion profit after taxes, if they paid any, which works out to a $1,200 profit per automobile as opposed to $313 per automobile for Toyota, $126 per automobile for Nissan and $90 for Mazda.

General Motors sold 6 million cars, of course, made a profit of $4.5 billion. Ford sold 2.27 million cars and made a net profit of $2.9 billion. I think this may explain the cost disadvantage that American manufacturers are working at, sir. We would welcome any of your questions.

[The prepared statement follows:]

STATEMENT OF THE AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION

SUMMARY

Ending the Voluntary Restraint Agreement on Japanese auto imports will not result in a flood of additional auto imports sufficient to damage the domestic industry.

The reduction in domestic car prices brought about by an end to the quotas will increase sales of U.S.-built cars so that the projected increase in imports from Japan will not increase the market share for the Japanese manufacturers significantly.

The reputed cost advantage held by Japanese automakers is not a consequence of either an undervalued yen or the Japanese tax structure. Indeed, Japanese cars sold in the United States bear a heavier tax burden than their U.S. competition. The over-valued dollar gives the Japanese a cost advantage of $200–$300, less than U.S. duties and shipping costs, since the bulk of costs in a Japanese car is in non-yen values.

Quotas have been counter productive in terms of U.S. employment. According to economic studies, higher prices as a consequene of the VRA have done more to reduce sales of domestic autos than any other single factor. Reduced sales mean lower employment.

U.S. manufacturers, in anticipation of an end to the quotas, already have acted to reduce prices on their small cars. Chrysler has announced a $500 discount; Ford will subsidize interest rates on its small cars. Lower prices will result in higher sales volume and additional employment.

There is no factual basis to the claim that the trade deficit is costing the U.S. jobs. Trade deficits historically accompany periods of high employment and economic prosperity.

Reports of idle Japanese productive capacity have been wildly exaggerated. On the basis of information gleaned on a recent trip to Japan, AIADA estimates Japanese automakers are operating at close to 90 percent of capacity. Even were they to achieve 100 percent of capacity, it would represent only an additional 700,000 vehicles. The U.S. normally receives only 25 percent of Japan's exports.

STATEMENT

There are many reasons why the "voluntary" restraint agreement on Japanese automobile exports to the United States should end. Most of them have already been presented, most persuasively, to this committee. They include:

The restraints have been instrumental in pushing automobile prices skyward; their chief contribution now is to hand windfall profits to the domestic automakers.

By eliminating competition at the low end of the market, the restraints have encouraged domestic manufacturers to ignore the development and marketing of low-priced, fuel-efficient automobiles.

By restricting the volume of Japan's principal export product to the United States, the quotas have encouraged the Japanese to take a more resistant attitude towards U.S. efforts at market-opening initiatives in other sectors.

To these, we would like to add another, and most obvious argument. The quotas have been counter-productive in their intended objective of increasing employment and production in the U.S. automobile industry. According to a study by the Wharton Institute of Econometrics, price increases resulting from the restraints did more to reduce domestic auto sales than any other single factor. According to standard theories of the elasticity of price demand, the increases reduced sales by as much as 450,000 units annually.

In 1981, the U.S. auto companies were handed a great opportunity. In the absence of any growth opportunities for Japanese companies, Detroit could have reduced prices and seized back a great part of the market share they had lost to imports. They could have become competitive in the small car field and entrenched themselves against the new wave of competition when the quotas ended. By undercutting competition, they could have expanded their capacity, thereby providing much additional employment.

Instead they elected to use the opportunity to raise prices, to increase their cash flow, to restore their debt-equity ratio and, eventually, to pay fat bonuses to executives and give the UAW a contract offering better than six percent a year wage increases. As long as competition is restrained, they will continue to follow the same course. Only the cold winds of competition will cool down the overheated price structure of the automobile market, bring millions back into the car market again and give America's heartland a solid and permanent basis for new economic growth.

The American automakers will argue that the marketplace has dictated their switch to larger, more expensive—and more profitable—automobiles. There is no market, they say, for cheaper economy cars. They even have asked for repeal of the Corporate Average Fuel Economy regulation, on the basis that they cannot sell enough fuel-efficient vehicles to meet the standard.

At the same time, however, they argue that, if the Japanese restraints are lifted, Japanese manufacturers will sell four million small cars in the United States. Obviously, they are arguing out of both sides of their mouths. The facts are that the Detroit manufacturers would prefer to keep the size of the market limited, so they can concentrate on the high profit end of the market and continue to ignore the low-profit economy car market.

Government should not be party to this conspiracy that is keeping at least two million Americans yearly out of the new car market.

It is time to return to competition in the automobile market. It is time to end the quotas on Japanese automobiles.

Because such arguments are, by now, familiar to this committee our testimony today will not dwell on reasons for ending the quotas, but instead will examine the arguments that have been presented in favor of an extension of the restraint agreement. Closer examination will reveal that most of these arguments are based on distortions of statistics and Malthusian predictions that are, as near as we can determine, based on no practical evidence at all.

As we have seen, proponents of quota retention have claimed that an end to the restraints will see the Japanese flooding the U.S. market at the expense of U.S. car sales. One Detroit executive said that in the absence of restraints, the Japanese would take 40 percent of the U.S. market. To achieve that, the Japanese would have to attain a sales increase of 216 percent.

Such a projection ignores all protections built into existing law for domestic industries. To any knowledgeable person in the automobile business, it is so far beyond the realm of the achievable as to be ludicrous. An increase of that magnitude by the Japanese producers is not possible in terms of productive capacity, dealer organization or market orientation.

The claim has been made that the Japanese manufacturers currently have an unused capacity for the production of two million vehicles. A team of AIADA executives returned from Japan only last week. We thoroughly explored this claim with the Japanese manufacturers. Their statement was that such claims were "absolutely unfounded."

Our own calculation is that Japanese producers are currently operating at about 90 percent of capacity—or roughly the same level as their American counterparts. The committee should recognize that 100 percent of capacity is virtually impossible to realize, since some of this capacity is represented by obsolete plants and part of it represents assembly lines down for changeover or repair.

Nevertheless, assuming the Japanese were able to reach perfection, full utilization of their productive capacity, it is the informed opinion of the AIADA team that

this would increase their present capacity by no more than 700,000 units. It must be kept in mind that the United States currently provides a market for only 25 percent of Japanese auto production. Japanese auto exports to other countries exceed shipments to the United States.

In recent years, the Japanese manufacturers have achieved a significant increase in their exports to other nations, while sales to the United States have stagnated, due to the VRA. It is illogical to assume, therefore that, as a Ford spokesman told this committee last week, that any increase in Japanese production would enter the U.S. market since, "they have no place else to sell it."

AIADA believes that no more than half of any increase would reach the United States, restricting potential growth to about 350,000 units until such time as the Japanese can expand their capacity.

The statement was made to this committee that the Chrysler Corporation, in anticipation of an end to the quotas, shortly would enter into an agreement with their Japanese affiliate, the Mitsubishi Corporation, to provide them with 200,000 additional small cars per year from Japan. This news is not calculated to set off any expressions of wild enthusiasm among Chrysler dealers, who, as recently as January, were sitting atop a 70-day supply of the imported product. Chrysler dealers have had difficulties in selling fewer than 90,000 Mitsubishi's in 1984. How are they going to handle 200,000?

The simple fact is that the Japanese do not have the capacity to increase their sales to the extent of the-sky-is-falling predictions made by Detroit manufacturers. Not only do they not have the dealer or distribution organizations to handle such volume, they do not compete in a sufficiently broad spectrum of the U.S. market to achieve such dominance.

The Japanese do not export to the United States any car larger than a compact. The majority of Japanese cars sold here fall into the sub-compact classification. The sub-compact market accounts for only 25 percent of car sales in the U.S. The compact market takes 30 percent of the total. The Japanese have no product that competes in the booming intermediate and full-sized markets. For the Japanese to take forty percent of the U.S. market would mean that the present balance between large and small cars would have to swing to a point where small cars were taking more than 80 percent of the U.S. market.

For all the popularity of Japanese small cars and their perceived domination of the U.S. small car market, the fact remains that U.S.-built small cars outsell their Japanese rivals by a better than 60–40 ratio. Given a more competitive pricing structure, there is no reason to doubt that the U.S. companies can maintain that market superiority, without the crutch of the voluntary restraint agreement.

Forecasts have been presented to this committee that show Japanese automakers creating huge inroads into domestic auto sales in coming months as a consequence of ending the VRA. Such prognostications usually are based on the assumption that the domestic manufacturers will retain their present inflated price structure. These predictions ignore the capacity of the Detroit companies to reduce prices to meet competition.

Indeed, both Ford and Chrysler have, in anticipation of today's ending the restraints, taken steps to improve their competitiveness in the small car field. Chrysler, with the majority of its sales in small cars, has announced a $500 price cut, nominally available to purchasers of Chrysler product in the past five years, an offer which dealers can be expected to extend to any purchaser.

Ford, while increasing prices on its larger cars for the second time in the model year, has annouced it will hold the line on the prices of its small cars, while offering subsidized interest rates on these vehicles--a price cut of significant magnitude, even if it is not advertised as such.

Renewed price competition at the low end of the market also can be expected to restrain the pricing policies of GM when it comes to putting the stickers on its California-built small cars that will result from its joint venture with Toyota.

Detroit, then, has given evidence that it intends to meet renewed Japanese competition head-on and that it will be price competitive. Consequently, the total sales of all automobiles, domestic and imported, should increase substantially in coming months and years. AIADA forecasts a 12 million car year by 1986, providing our economy remains strong.

In order to satisfy such a booming market, Detroit would have to expand its present capacity, employ more autoworkers and increase its purchases of iron and steel, aluminum and rubber, parts and components. Overall, Detroit profits might fall from their present stratospheric levels, particularly on a per-unit basis, but for the American economy, the autoworker and the supplier industries, the growth in sales would provide a bonanza.

In the face of such a boom, even if Japanese auto imports increased by as much as 500,000 units, there would be little change in the share of market held by imports.

Employment and trade deficits

Unable to argue the auto industry's need for further protection, in light of profits doubling their previous records, resurgent employment, lavish executive bonuses and $60,000-per-year wage packages for workers. Detroit has turned to the troublesome U.S. trade deficit as justification for retaining the VRA.

The trade deficit, they argue, has cost the United States more than two million jobs. Therefore, ending the restraints on auto imports will cost the U.S. even more jobs—750,000, by one estimate, or about the total now working in the U.S. auto industry.

Included in this statement is an analysis of the relationship between employment and trade deficits for AIADA by Doctor Charles Pearson, professor of economics at Johns Hopkins University. Dr. Pearson's paper illustrates that there is no discernible connection between trade deficits and unemployment. Indeed, employment is usually at its highest during periods of large trade deficits.

As with any attempt by government to rig the marketplace in order to achieve a desired result, the voluntary restraint on Japanese automobile exports to the United States has produced a chain reaction that brilliantly illuminates what has come to be known as the "law of unintended consequences."

Among the unplanned results of this seemingly simple limitation on sales of a single product from a single country have been:

—a decline in the rate of investment in new plants and equipment by domestic auto manufacturers; [1]

—a reduction in the capacity of those same manufacturers;

—a $16 billion increase in consumer expenditures for automobiles;

—a doubling of sales of light trucks;

—a fifty percent increase in the average price of used cars;

—an increase of $17 billion in annual consumer expenditures for automobile repairs:

—and a host of other undesirable side effects. What a Pandora's box we open when we tamper with the workings of a free market!

The tilted playing field

The argument has been made and repeated by those who profit most from the continuation of restrictions on imported automobiles that they require government protection from this competition because of what they allege is an "unfair" advantage accorded to the Japanese manufacturers by their government. They have used the colorful phrase, "the tilted playing field" to describe the supposedly inequitable conditions under which they labor in a commendable effort to turn a profit. The basis of their claim of "unfairness" is an alleged cost advantage enjoyed by the Japanese automakers that is a consequence of a manipulated yen and an export-driven tax policy.

The amount of this claimed cost advantage varies wildly according to the claimant, but it seems to average out at about $1600 per vehicle. The statement has been made to this committee that $900 fo this advantage is due to a supposed under-valuation of the Japanese yen, while $700 is caused by Japanese tax policies that give an unfair advantage to exports.

In our testimony, we will show this committee that there is no basis in fact for this claim of an unfair cost advantage. Japanese cars sold in the United States, in fact, carrry a heavier tax burden than do their domestic competition. The yen/dollar relationship has only a minimal effect on the price of a Japanese car sold in this country. The principal cost advantage enjoyed by the Japanese manufacturers would appear to be a willingness to settle for a far smaller margin of profit than their American competitors.

As far as the yen-dollar relationship is concerned, no one in this room, or anyone who reads a newspaper, needs reminder that the United States dollar has become dangerously over-valued against virtually every currency in the world. Under the circumstances, charges that the Japanese have manipulated the yen to the advantage of their exports need hardly to be considered seriously. Such charges have been thoroughly investigated and refunded by the Secretary of the Treasury, the Chairman of the Council of Economic Advisors and a task force headed by the Under Secretary of the Treasury.

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[1] Testimony of Robert Crandall, February 28, 1985.

Surely, if the Japanese have tried to manipulate the yen, they have done a poor job of it. Between 1980 and 1984, the yen remained almost stable against the dollar, while every other major international currrency depreciated between 25 and 100 percent. Even today, the yen has depreciated only 11 percent against the dollar in five years, while the franc has depreciated 130 percent, the mark by 74 percent and the pound by 94 percent.

Nonetheless, Ford, Chrysler and the UAW continue to claim that an undervalued yen gives Japanese auto makers a $900 cost advantage over Detroit's manufacturers. They rationalize this claim by saying the yen is undervalued by 15 peercent, then by taking 15 percent of the cost of the Japanese subcompact ($6000) and posting that as a cost advantage.

As Economist Martin Anderson has pointed out in a four year study conducted by the Massachusetts Institute of Technology, this is specious reasoning. Very little of that $6000 is in yen-related costs. Dealer profit and costs are in dollars. Advertising and marketing costs are in dollars. Transportation costs are in dollars. U.S. tariffs and taxes are in dollars. The Japanese buy the bulk of their raw materials in currencies other than the yen. All of the manufacturer's energy costs are in dollars.

"A big chunk of Japanese expenses and profits is not in yen and has nothing to do with the yen," Anderson days. He contends the real cost advantage resulting from the overblown dollar is no more than $200 or $300 per car—less than the cost of U.S. duties and transportation—and that it is largely temporary, since, sooner or later, the dollar will drop or the yen will rise.

The alleged tax advantage enjoyed by Japanese automakers is even more illusory than the supposed cost advantage resulting from the yen/dollar relationship. Recent authoritative studies have established that Japanese cars, rather than enjoying the reported $700 tax advantage over their American competition, are actually taxed at a heavier rate. Temple, Barker and Sloane, a Massachusetts-based research firm, has concluded that the total tax burden on Japanese cars sold in the American market is heavier than that of American cars sold here.

In essence, Japanese imports must overcome a cost disadvantage in the matter of taxes, when competing in the U.S. market. This results largely from the Japanese corporate income tax which is nearly double that of the United States.

Those who advocate continuing restraints on Japanese imports are merely confusing the issue when they claim that, by not charging its commodity tax on exports, the Japanese government gives its automakers a $700 advantage. There is no commodity tax on Japanese cars sold here, but there is no commodity tax on domestic automobiles, either. No amount of obfuscation can hide the fact that there is a lower tax burden on U.S. cars than there is on Japanese imports.

Another argument favored by those seeking additional protection is the familiar one that exports deprive the Federal treasury of tax revenue that would be received were the product produced in the United States. Such a tax "loss" is, of course, a fact of international trade. The claim, however, overlooks the tax "gain" that accompanies the sale of American products overseas. Import competition expands the market, generating revenue that otherwise would not exist.

It is worth noting, however, that the sale of an imported automobile in the United States generates $1180 in tax revenue. In 1982, these sales generated nearly $3 billion in U.S. taxes.

The leading exponent of the "tax loss" argument has been the Chrysler Corporation. It is not meant as criticism of that organization or its spokesmen, but simply as a matter of record, to point out that import duties collected by the United States government on the importation of Japanese automobiles in the single year 1984 was $864 million. This is more than twice as much as the Chrysler Corporation has paid in Federal income taxes in the fifteen years since 1969, even excluding the $266 million Chrysler has received in refunds.

That legendary Japanese cost advantage

What then, of the now legendary Japanese cost advantage? If such an advantage really exists—and there is considerable question on the subject—on what is it based? An examination of the annual statements of Detroit's Big Three versus the major Japanese companies would indicate that the largest single item in any cost advantage is the Japanese lower profit rates.

According to their annual reports, in the most recently concluded Japanese fiscal year, the Toyota company, most profitable of all Japanese automakers, turned a net profit of $1.057 billion on total vehicle sales of 3,372,429 vehicles. This calculates out to a net after tax profit per each new vehicle retailed of $313.

Nissan reported net earnings of $315 million on sales of 2,499,000 vehicles, for a net profit per vehicle of $126.

Mazda reported a net profit of $121 million on sales of 1,336,100 units, for a net profit per vehicle of $90.

By contrast, in 1984, the Chrysler Corporation, on sales of approximately 2,000,000 units, reported a net profit of $2.4 billion—two-and-a-half times Toyota's profits, and for fewer vehicles. Chrysler's profit per new vehicle sold works out to an astronomical $1,200.

Ford turned a net profit of $2.9 billion on sales of 2,467,359. GM, with sales of 6,022,713 units, reported an all-time record net profit of $4.5 billion, despite a costly strike.

Aside from a lower profit-per-vehicle level, the principal Japanese cost advantage lies in greater productivity and more efficient use of its workers' time. The fact that the Japanese manufacturers are able to produce a small car with fewer man-hours than their U.S. competition does give them a measurable cost advantage. This advantage is not restricted to the hourly wages paid, but since fewer hours are involved, it also encompasses social taxes paid by the manufacturer on the workers' wages and the cost of the many fringe benefits paid by manufacturers of all nationalities.

The significance of this advantage should not be over-emphasized however, since labor represents only about ten percent of the total cost of the vehicle. Nor should the lower hourly wages of Japanese workers be given undue import, since they do not represent the many labor costs Japanese automakers must bear that are not borne by their Detroit counterparts, including lifetime employment guarantees, subsidized housing, subsidized food and clothing and educational benefits.

It would not appear the role of the government, however, to insulate domestic manufacturers from competition from foreign manufacturers whose only offense has been to produce a superior product more efficiently. Such a policy could lead only to an increasingly subsidized and non-competitive industry.

Although one UAW official, in an emotional statement once characterized the income of Japanese auto workers as "slave wages," the average American industrial worker makes less than the average Japanese auto worker. Such an income would appear to be "slave wages" only from the viewpoint of the UAW members, whose annual wage and benefits package will reach nearly $60,000 before the end of the current three-year contract.

America's trade problems undoubtedly have their roots in an over-valued dollar, but there is significant evidence that attempts to remedy trade problems through quotas or tariffs on imports have only pushed the dollar higher, further exacerbating the problem. According to the respected London "Economist," American corporate profits expanded by 58 percent between 1982 and 1984. The most profitable industries were those shielded from foreign competition and none improved its profitability more dramatically than the automobile industry.

The immense profits of U.S. corporations, resulting from changes in the corporate tax structure, a resurgent economy and protection from price competition, has attracted a huge influx of foreign investment, which has generated a quantum increase in the value of the dollar, thereby greatly worsening the trade situation.

TRADE, EMPLOYMENT AND THE AUTO QUOTAS

The relation between U.S. trade and domestic employment is often misunderstood. Some assert that:

Increased imports and the trade deficit have cost the U.S. up to 2 million jobs in recent years.

Japan is mainly responsible for the increase in imports and the U.S. trade deficit.

Extending the Voluntary Export Restraint program on autos would reduce the trade deficit, aid the U.S. auto industry, and help open up the Japanese market to U.S. exports.

These propositions are factually incorrect, violate common sense, and would damage U.S. economic interests. The better policies are to:

Reduce the Federal deficit and bring down the strong dollar.

Vigorously enforce U.S. trade laws prohibiting unfair trade practices.

Take positive measures to improve adjustment and productivity and to reduce unemployment.

1. Trade and employment

Increased imports and an increasing trade deficit do not create unemployment. On the contrary, an expanding economy creates jobs, reduces unemployment and increases imports.

The statistics tell the story very clearly. As shown in Table 1, U.S. employment went from 85.8 million jobs in 1975 to 106.3 million jobs at the end of 1984, a gain of 20 million jobs. At the same time imports increased from $98 billion to $328 billion, and the trade balance fell from a surplus of $9 billion to a deficit of $108 billion.

The only years in which employment fell (1975 and 1982) imports actually declined and the trade balance improved. In fact, a decline in imports and a worsening of the trade deficit are associated with a decline in unemployment.

Table 2, which looks at year to year changes in employment and trade, tells the same story. 1984 saw the largest gain in employment and the largest drop in the unemployment rate. And it also saw the largest increase in imports and the largest increase in the trade deficit.

From 1982 through yearend 1984 the U.S. economy added 6.8 million jobs, and the unemployment rate fell 2.5 percentage points (Table 3). Imports increased $80 billion, and the trade deficit increased $71 billion.

There is no mystery here. The vigorous U.S. economic recovery creates jobs, shaves unemployment rates, and attracts imports.

Some might argue that had the U.S. restricted imports, the employment gain might have been even greater. This is unlikely.

First, import restrictions would have caused even stronger upwards pressure on the dollar, further crippling U.S. export industries, causing job losses in the export sector.

Second, U.S. imports have been a significant force in stimulating foreign economic recovery. For example, U.S. imports from Germany are estimated to account for half of the German increase in economic growth in 1983.[1] Foreign economic growth helps U.S. exports and employment.

Third, imports reduce inflationary pressure. Restrictions on imports would have forced the Federal Reserve to slow monetary growth with a less bouyant recovery, costing additional jobs.

TABLE 1.—TRADE AND EMPLOYMENT

	Employment [1] (millions)	Unemployment [1] rate (percent)	Imports [2] (billions)	Trade [2] balance (billions)
1975	85.8	8.5	$98.2	+$8.9
1976	88.8	7.7	124.2	−9.5
1977	92.0	7.1	151.9	−31.1
1978	96.0	6.1	176.0	−34.0
1979	98.8	5.8	212.0	−27.6
1980	99.3	7.1	249.8	−25.5
1981	100.4	7.6	265.1	−28.0
1982	99.5	9.7	247.7	−36.5
1983	100.8	9.6	261.3	−61.1
1984	105.0	7.5	327.9	−107.6
Year end 1984	106.3	7.2		

[1] Civilian.
[2] Merchandise trade.

Source: CEA, Economic Report of the President, 1985; U.S. Department of Commerce.

TABLE 2.—YEAR TO YEAR CHANGE IN TRADE AND EMPLOYMENT

	Employment (millions)	Change in unemployment rate (percent)	Imports (billions)	Trade balance (billions)
1975	−1.1	+2.9	−$5.7	+$14.4
1975	+3.0	−0.8	+26.0	−18.4
1977	+3.2	−0.6	+27.7	−21.6
1978	+4.0	−1.0	+24.1	−2.9
1979	+2.8	−0.3	+36.0	+6.4
1980	+0.5	+1.3	+37.8	+2.1
1981	+1.1	+0.5	+15.3	−2.5

[1] Morgan Guaranty, World Financial Markets, April 1984.

TABLE 2.—YEAR TO YEAR CHANGE IN TRADE AND EMPLOYMENT—Continued

	Employment (millions)	Change in unemployment rate (percent)	Imports (billions)	Trade balance (billions)
1982	−0.9	+2.1	−17.4	−8.5
1983	+1.3	−0.1	+13.6	−24.6
1984	+4.2	−2.1	+66.6	−46.5

Source: CEA, Economic Report of the President, 1985.

TABLE 3.—*Trade and employment changes 1982-84* [1]

Employment gain: 6.8 million jobs.
Decline in unemployment rate: 2.5 percentage point decline.
Increase in imports (annual): $80.2 billion.
Increase in trade deficit (annual): $71.1 billion.

[1] Year end 1984.

Source: CEA, Economic Report of the President, 1985.

Finally, import restrictions create inefficiencies, reduce productivity, and force U.S. firms to use high cost imputs. These productivity loses would have further harmed U.S. international competitiveness and cost additional jobs.

There is a serious unemployment problem in the U.S., but it is the result of adjusting to productivity growth and to rapid shifts from basic industries to a high-tech manufacturing and a services based economy.

These changes are dramatic. Manufacturing production increased 38% in the 1970s, but manufacturing jobs by only 5%. Productivity increase is the key. Had productivity remained constant, a hypothetical 6.6 million additional jobs would have been "created" in manufacturing. But no one can seriously argue that the U.S. should freeze productivity gains to save jobs.

From 1970 to 1980 output increased 24% in textiles and 39% in paper, but employment declined 13% and 2% respectively. But new jobs were opening up other manufacturing industries. For example, employment in non-electrical machinery was up 25% and in instruments was up 35%.[2]

By 1982, 69% of U.S. employment was in services. Of the 20 million new jobs created in the 1970s, 18 million were in the services sector, many in information industries.

The answer to the U.S. unemployment problem is not trade restrictions, which frustrate adjustments, but vigorous economic growth and improving structural adjustments.

2. Causes of the trade deficit

The U.S. trade deficit is caused by three factors: more rapid economic growth in the U.S. than abroad; the strong dollar; and the austerity measures in the debt-ridden developing countries. Japan is not responsible.

The U.S. trade position has worsened by $85 billion since 1980. Had it not been for reduced expenditure on imported oil, the decline would have been about $105 billion.

The Council of Economic Advisors estimates the causes of this loss as follows:

	Billion
Due to appreciation of the dollar	$65
Due to faster U.S. growth	21
Due to debt problems of developing countries	19
Total	105

Several forces contribute to the strong dollar. One is the great success that the U.S. has had in controlling inflation. A second is the strong growth performance of the U.S. economy in recent years. A third is the relatively high nominal and real interest rates in the U.S.

This last factor is clearly related to the massive Federal deficit and consequent government borrowing needs. Total financing needs for U.S. private investment and

[2] USTR, Annual Report to the President 1983 (April 1984).

for total government borrowing (federal, state and local) in 1984 was about $780 billion. Private and business savings were about $680 billion. With demand exceeding supply, real interest rates have remained high and foreign capital flowed in massive amounts to the U.S. This has pushed the real effective exchange rate for the dollar upwards by 61% since 1980, and by 68% in nominal terms.

The U.S. balance of payments must balance. With a capital inflow in excess of $100 billion, the current account deficit must exceed $100 billion, and the strong dollar has driven the trade deficit to $108 billion.

Once again, there is no mystery here. The dollar is strong and the trade deficit is enormous because U.S. savings do not equal our investment and government deficit needs. Japan is not responsible.

The problem of the trade deficit cannot be solved by trade restrictions. It requires a credible attack on the Federal budget deficit and longer term measures to stimulate domestic savings.

Indeed, even if the U.S. trade deficit were analysed on a bilateral basis, which is inappropriate, Japan should not be singled out.

As table 4 shows, the Japanese share of the U.S. trade deficit fell from 39% in 1980 to 34% in 1984.

Nor is there any evidence that the appreciation of the dollar against the yen has been disproportionate. Indeed, as shown in Table 5, the dollar strengthened 21% in real terms against Japan, but 90% against the Dutch gilder, 84% against the British pound, and 77% against the Duetchmark.

TABLE 4

[In billions of dollars]

	U.S. trade deficit	Trade deficit with Japan	Japan share of U.S. trade deficit (percent)
1980	$25.5	$9.9	39
1984	107.6	36.8	34

TABLE 5.—*Percentage real appreciation of the dollar January 1980 to January 1985*

Percent appreciation against the currency of:	*Percent*
Japan	20.7
Netherlands	89.7
U.K.	83.6
Germany	77.0
Canada	6.5

NOTE: Industrial or Wholesale Price Indices used except for Netherlands.

Source: IMF, International Financial Statistics; New York Times.

3. Extending the so-called voluntary export restraints on autos

No one can seriously argue that the U.S. auto industry needs continued extraordinary protection.

1983 and 1984 have been banner years. Combined 1983 and 1984 profits for General Motors, Ford and Chrysler are $16.1 billion (Washigton Post, 2/15/85, p.F1).

The cost of the restraints, paid for by U.S. consumers, has been enormous. Robert Crandall estimates the cost of restraints to consumers in 1983 to be $4.3 billion, or $160,000 per auto industry job saved.[3]

In a recent report, the U.S. International Trade Commission estimates the quotas have cost U.S. consumers a total of $15.7 billion, or $357,000 per job saved.

A final argument might be that continuation of the quotas would signal U.S. determination to press for improved market access for U.S. exports in Japan. This argument is flawed.

First, in terms of formal barriers to trade, Japan is less restrictive than the EC, and probably less restrictive than the U.S.[4]

[3] Robert Crandall, "Import Quotas and the Automobile Industry: The costs of Protection", The Brookings Review, 1983.

[4] See USTR, Annual Report to the President 1983, April 1984.

Second, the auto export quotas provide a windfall profit to Japanese auto makers, and an opportunity for industry control for the Japanese Ministry of Trade and Industry (MITI). Thus extension is not a credible threat to increased market access in other areas.

Third, the auto quotas have been in effect for four years. Any possible leverage value has been exhausted by now.

4. Preferred policies

The problem of the dollar, the trade balance, and unemployment should be addressed with the three-pronged strategy.

First, a credible attack on the Federal budget deficit is badly needed to reduce upwards pressure on the dollar. This is the single most important measure to reduce the trade deficit and restore U.S. international competitive position.

Second, the United States should vigorously enforce its domestic legislation against foreign unfair trade practices. This includes not only antidumping and countervailing duties, but the expanded authority under Section 301 of the 1984 Trade Act to eliminate foreign trade practices that harm U.S. export interests.

Third, the United States should continue and expand *positive* adjustment measures that promote greater efficiency and productivity and increase U.S. investment. These measures include improved labor retraining and continuation of tax measures that have successfully increased business investment and productivity.

Chairman GIBBONS. Well, thank you. Is it true the profits reported by Toyota and other companies stem largely from sales in the U.S. market and not in the domestic market?

Mr. MCELWAINE. That claim is made by the Detroit manufacturers. It was one of the things we tried to explore when we were in Tokyo, without much success, by the way. These profit figures are all lumped together as most corporations do and breaking them out country by country is hard, but it is difficult to imagine they could be making 100 percent of their profit from 25 percent of their sales, which is all we represent.

We only represent a little over 40 percent of Japan's exports. And their other markets outside the United States have been growing at a more rapid rate than their U.S. market has under this restraint arrangement. I can't conceive that they are making the percentage of profits from the U.S. market that they have been accused of, but undoubtedly under the restraints it has been a much more profitable market than it was previously or that it will be now.

Chairman GIBBONS. Of all of the American firms, that import Japanese cars, which is the biggest importer?

Mr. MCELWAINE. The biggest importer is the——

Chairman GIBBONS. I mean General Motors imports some; does Ford? I don't know if they do or not.

Mr. MCELWAINE. Ford at this time is not importing Japanese automobiles—they are importing some from Europe, bringing in the Merker, and Sierra from Europe, but they are not importing from Japan that I am aware of.

Chairman GIBBONS. Where does Chrysler stand in the import picture?

Mr. MCELWAINE. With 87,000 cars last year from Mitsubishi, not very high up in the—they would be selling more than the Mitsubishi dealers would, more than the Isuzu dealers, but not very high up there really.

Chairman GIBBONS. But do they import more cars than Ford or General Motors?

Mr. MCELWAINE. From Japan, yes.

Chairman GIBBONS. So they are the biggest of the automobile importers from Japan as far as the manufactuers are concerned?

Mr. MCELWAINE. That's right.

Chairman GIBBONS. How about their engines and things of that sort, do they still import from Japan?

Mr. MCELWAINE. A substantial quantity of engines are made by Mitsubishi in Japan for Chrysler automobiles. Their larger four-cylinder engine, their 2.4 liter engine is made largely in Japan.

Chairman GIBBONS. I am talking Chrysler now.

Mr. MCELWAINE. Yes, Chrysler owns 15 percent of Mitsubishi, so Mitsubishi is essentially an affiliate, and they are manufacturing those engines in Japan.

Chairman GIBBONS. Where is the Chrysler Caravan made? Do you know that?

Mr. MCELWAINE. I think it is made in Canada.

Mr. NIELD. That model is made in Canada.

Chairman GIBBONS. Are they all?

Mr. NIELD. At the present time; yes.

Chairman GIBBONS. I was going to try one out, and they said it was the most popular car they had, but you say it is an import, too.

Mr. MCELWAINE. Canadian and domestically produced vehicles are lumped together under North American production. The manufacturers don't really consider them imports.

Chairman GIBBONS. But they show up in trade statistics.

Mr. MCELWAINE. Definitely, yes.

Chairman GIBBONS. We have lost more trade with Canada on balance than we have with Japan.

Mr. MCELWAINE. Yes.

Chairman GIBBONS. As I recall, we have lost about $27 billion worth of trade with Japan in the last 4 years. But we have lost far greater than that with Canada in the same 4-year period.

Mr. NIELD. That's right.

Chairman GIBBONS. I didn't realize that Chrysler's most popular car was an import.

Mr. MCELWAINE. Roughly 10 percent of all so-called domestic automobiles are produced and imported from Canada. I see these are 1983 figures, but in 1983, our automotive imports from Japan were at $11 billion, and from Canada were a little more than $7 billion.

In 1985, Japan's imports went up a little over $12 billion, and as I remember it, Canadian was $8 billion. So it is a substantial increase. Incidentally, the figure was given earlier today that the automobile sales accounted for $20 billion of our $30 billion deficit with Japan, $20 billion represents the retail price of the product.

The actual contribution to the Japanese trade deficit is $12 billion which is significant enough without stretching it to $20 billion.

Chairman GIBBONS. Interesting point. I had not caught that.

Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman.

I want to congratulate you gentlemen for your testimony. You have reinforced some convictions that I had with startling figures that you have presented. I look forward to getting all those figures and mastering them myself in anticipation of future debates on

this subject. But it tends to confirm what I believe had to be the case.

One of the things that strikes me as remarkable, though, is that you people as importers make the plea for ending the voluntary restraints which is calculated to increase the competitiveness. Does that not adversely potentially down the line affect your profit picture?

Mr. McELWAINE. I can say that I have some members of our 7,000 member association who have asked me if I am crazy to keep arguing that the quotas should end because they have been making great profits. But I think most of our members are pretty farsighted and feel if quotas can be set at 1,850,000 this year, next year they could be 1,200,000 or 1,400,000, and as long as we have that leash around our necks we are subject to Detroit's own performance.

Should Detroit sneeze, we would all get pneumonia. Nobody wants that. Also the breed of people who essentially become automobile dealers—and Mr. Horvath represents them as well as anyone I could possibly think of—tend to be pretty dedicated entrepreneurs who don't really like the idea of a controlled marketplace even if they are getting rich out of it.

Mr. CRANE. I congratulate you for that. One of the startling figures I saw just recently was the magnitude of the contract the UAW signed in 1984 with the auto manufacturers, 17 percent increase in labor costs over 3 years. Considering the more modest labor costs in Japan, A, and B, the greater correlation between what they pay out to auto workers versus manufacturing labor as a whole, do you think this is going to adversely impact the executive position of Detroit with this relaxation finally of these so-called voluntary restraints?

Mr. McELWAINE. I think the successful conclusion of a contract which sees to it that the autoworkers will receive a wage and benefits package totaling $60,000 a year per employee by the end of the contract period represents more in evidence that the industry does not need protection than it does any imbalance in cost figures between Japanese and U.S. firms, simply because labor is not that significant a contributor to the overall cost of the product.

Labor really represents only about 10 percent of the cost of the product today. The Japanese are producing small cars with 35 hours of—35 man-hours of labor in the assembly operation. Even at a $10 an hour wage difference, you are only talking $350 in a $8,000 to $10,000 product.

Mr. CRANE. Let me ask you a followup question in that regard, because those labor cost percentages are startling.

In breaking down that gross income dollar in Detroit, can you give me a rough explanation of what the percentages are, is 10 percent of it alone the cost of labor? What are the other percentages? Do you have a general idea? Any ball park figures?

Mr. McELWAINE. I couldn't give you specifics on it. I know one of the things we studied in Japan, though, was areas of cost where the Japanese are at a disadvantage. It included energy costs where they pay substantially more. Land costs are much higher there, transportation costs, of course, tax costs where the Japanese corporations pay nearly double the U.S. corporate tax rate. That is out-

side of your commodity tax entirely, which is paid essentially by the consumer, of course. Those are major items.

Overhead costs, inventory costs, the Japanese substantially undercut U.S. manufacturers on inventory costs, and I know the U.S. manufacturers have studied this and are moving to try to emulate them at the moment. But those are all areas—overhead costs. Again, the Japanese have a great advantage on overhead costs. They have significantly fewer levels of management, and significantly lower management costs as a result.

These are all areas that figure in the final cost.

Mr. NIELD. There is one thing I might add to that answer. I notice the manufacturers are apparently aware of the significance of labor costs. The negotiatons for the new Mazda facility to be built in Michigan will have a different wage relationship than the existing manufacturing plants in that area.

This is with regard to the dollar per hour wage rate. The productivity of the workers and allowing workers to perform more and different tasks will also be included. Also the Saturn project will have a separate wage negotiation. So there is a sensitivity there that I think is healthy.

Mr. CRANE. I was in Japan in 1981 with the American Productivity Center, and we visited the Nissan plant and watched everything from the stamping operation through the entire body assembly, which was totally robotized at that time, including door panel assemblies, and they were explaining to us the efficiencies, and greater quality control, and no cigarette breaks, and so forth, coupled with the fact you could let the robots work 24 hours a day with just a few people at some control panel.

And watching their workers, too, in the portion of the assembly as we watched it until they were rolling brandnew Datsuns off the production line, I think we were all awed with the quality of the workmanship that went into those cars. It was just an awesome thing to behold. One of the questions put to us when we met with management to discuss some of our problems here at home was this whole robotization of the entire production line at that time.

They reminded us that we invented robots in this country and they applied them there. And they were curious as to why we had not been pioneers in this area and noticed that 70 percent of the world's operational robots were in Japan at that time. It is a little hard to answer some of those perplexing questions the Japanese put to you and put in their most polite way about dumb things we have been doing to ourselves here at home, inflicting wounds on ourselves, and our own capabilities when they learn those from us and apply them over there.

The only conclusion we could reach was that American businessmen ought to go visit Japan with a great deal of humility and see what they have done with a lot of these ideas that they will freely tell you they learned in this country, and have applied, and applied very well.

I just want to congratulate you and your testimony, and I look forward to trying to digest some of those figures.

Mr. MCELWAINE. Thank you. You illustrated the point I intended to make about labor costs which is that the difference in wages is less important than the amount of man-hours involved. In other

words, if you produce cars with 35 man-hours of labor and there is a $10 wage differential, you are talking $350. But if on top of that it takes the American manufacturer 35 more man-hours to produce the same car, at $20 an hour, you are talking about a $700 additional wage differential.

That is where the big increase is. It is not in the real labor costs. It is in the usage made of labor in the productivity.

Mr. CRANE. Is that roughly the ratio; that it takes double the man-hours to produce an American car versus the man-hours of a Japanese-made car?

Mr. MCELWAINE. That is our understanding, 35 to 70 is the number.

Mr. CRANE. Thank you.

Mr. NIELD. Mr. Whipple from the Ford Motor Co. last Thursday indicated that it takes 155 hours in Detroit to build the same size car that would take 110 hours in Japan.

Mr. MCELWAINE. He includes raw materials production, and overhead, and management assembly operations, though being 35 to 70.

Mr. CRANE. Thank you.

Chairman GIBBONS. The assembly operations are 35 and 70?

Mr. MCELWAINE. Thirty-five man-hours for a Japanese small car, 70 man-hours for a U.S. car.

Chairman GIBBONS. Roughly the same car you are talking about?

Mr. MCELWAINE. Comparable automobiles, yes.

Chairman GIBBONS. Are you real sure about those figures?

Mr. MCELWAINE. Those are the figures we have gotten from several studies including the Martin Anderson study and others that have been offered in the past.

Chairman GIBBONS. Well, that really doesn't say much for the great American ingenuity, does it? Or the great American productivity.

Mr. CRANE. Mr. Chairman, could I request if that is not part of the record, if he could get us those figures, too? Could all that be made a part of the record?

Chairman GIBBONS. Yes.

Mr. CRANE. Thank you.

[The following was subsequently received:]

A new future for the world's carmakers

The world's motor industry, 100 years old this decade, is on the edge of its fourth and most difficult transformation. How the carmakers manage it will not just determine the shape of the world's largest manufacturing industry. It will set a precedent for manufacturers as a whole.

Motor industry pundits used to see the future as follows: small cars would come to dominate world markets, as pressures for energy conservation and environmental protection grew; high-volume and low-cost manufacture would win the competitive day; of today's roughly 20 final car assemblers in the west, perhaps half a dozen big groups would remain; and they would shift more and more production to low-wage countries.

That is a wrong view, say the authors of a massive study* of the world motor industry masterminded by the Massachusetts Institute of Technology and released this week. For four reasons.

- Computer-controlled production has knocked on its head the old theory that 500,000 vehicles or so was the minimum scale of efficient production. Specialised producers will continue, though they may have to collaborate on, eg, engines, where volume is still crucial.
- New components technology has made possible a wider range of fuel-efficient cars (and the drop in oil prices has made energy saving less important).
- National markets are not converging: they continue to want different cars.
- The reaction of western car producers to Japanese production inventions, and Japanese adaptations to the flexible manufacturing systems in western countries where the Japanese companies are gradually taking root, have quickened the competitive cycle of technological change.

The upshot of all this? The line-up of today's producers will remain broadly unchanged until the end of the century. Though they will co-operate increasingly on certain projects, they will compete harder in others. Production is likely to become more concentrated at the point of final assembly, to maximise benefits from "just-in-time" inventory management. And final assembly will remain near major markets, as flexible manufacturing systems make differentials in unit labour costs less important.

Coping with this fourth life crisis will be harder than managing the industry's first three. These established a predictable pattern. Innovation in one country produced a competitive advantage; other producing nations put up trade barriers to blunt it; the pace of change was slow and consumers paid the price.

That first happened around 1910, when American mass-producers nudged aside European custom-builders. European countries slapped hefty tariffs on imported cars and components, forcing the Americans to invest there.

European producers languished in too-small national markets, until tariff barriers began to fall within Europe in the 1950s. Access to a bigger European market gave local producers a chance of economies of scale. From this second turning point, the Europeans outpaced their American mass-production mentors at home and abroad (see chart).

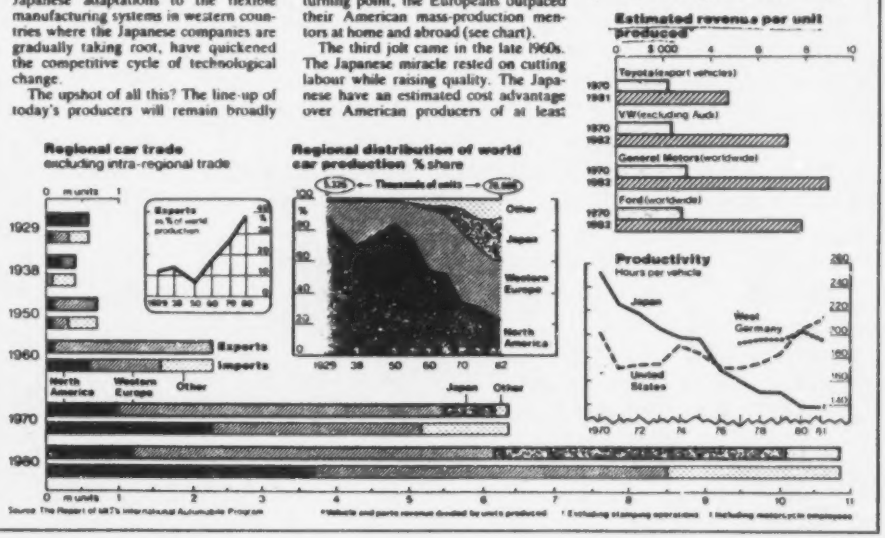
The third jolt came in the late 1960s. The Japanese miracle rested on cutting labour while raising quality. The Japanese have an estimated cost advantage over American producers of at least $2,000 per car, and over many Europeans of $500-700. A realistically stronger yen would only reduce it. From 1975, the west has responded with trade barriers.

American and European carmakers are copying and collaborating with the Japanese. They may not be doing it fast enough to overcome the competitive gap, which, with rapid technological change, is what makes this fourth crisis harder than the previous three.

Can uncompetitive national car industries catch up while avoiding high unemployment and industrial unrest? Maybe, says the MIT team, if different countries do different things:

- America must encourage direct foreign investment in America and joint ventures with foreigners. It must stop protecting its car industry when markets and profits are growing, and sort out its energy policy more clearly.
- Germany and Sweden, whose producers are competitive for the moment in the luxury-car market must avoid the trade barriers and find other things for redundant car workers to do.
- Britain, France and Italy, whose domestic industries are traditionally uncompetitive (with the recent exception of Fiat) and protected, should concentrate on collaboration and direct investment to modernise themselves.

*"The Future of the Automobile: The Report of MIT's International Automobile Program." 1984. George Allen & Unwin in UK.



Source: The Report of MIT's International Automobile Program

Table 7.1
Long-term debt as a percent of long-term capital for leading Japanese and American auto companies, 1971–1982

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Honda	57.8	54.6	51.4	46.3	52.9	51.8	39.5	28.9	32. 3	26.0	19.7	25.1
Nissan	37.7	27.3	24.5	29.4	25.4	18.4	15.5	12 4	14 .2	11.1	16.1	n.d.
Toyota	11.0	7.9	5.0	3.6	2.1	0.8	0.0	0.0	0.0	0.0	0.0	0.0
GM	5.1	6.3	5.7	6.5	8.5	6.8	6.3	5.3	4.4	9.6	17.7	19.6
Ford	12.6	14.3	13.2	19.1	19.4	16.6	13.8	10.6	10.9	19.4	26.9	26.4

Ratios = long-term debt/(long-term debt + equity), n.d = no relevant data available.
Long-term debt for Japanese companies excludes severance and pension liabilities.
Sources:
Martin L. Anderson, "Financial Restructuring of the World Auto Industry," paper prepared for International Automobile Program International Policy Forum, Hakone, Japan, May 1982, and calculations by the authors based on corporate annual reports.

in 1983, the $15.7 billion in cumulative negative cash flow at GM and Ford for the years 1979–1982 (table 7.2) marked a historic transfer in financial strength from the American industry to the Japanese. The Americans and several European producers must hope for prolonged stability in the marketplace, because the 1979–1982 slump has all but exhausted their ability to obtain external financing for new-product development.

When all the parts of the Japanese system of production organization—within the plant, between plants, and within the group financial planning system—are tied together, they yield cost advantages quite independent of factor costs. They also provide higher product quality through manufacturing accuracy at all levels, greater system flexibility to develop new products and to shift the mix, robust cycle endurance, and guidance mechanisms in the financial system that provide intense feedback on producer performance.

An American-European-Japanese Cost Comparison

The cost advantages of the Japanese system are worthy of special comment, not only because of the attention they have attracted in other auto-producing nations but also because of the need to assess carefully the role of production cost in overall competitiveness. However, assessing comparative costs is a complex task made more difficult by problems of product comparability, differing degrees of capacity utilization, exchange-rate fluctuations, and the proprietary nature of much of the information that is useful for cost estimation. Nevertheless, we estimate that the U.S.-Japan production cost difference on a typical smaller car exceeds $1,500 (at 215 yen = $1) and that some recent estimates of the U.S.-Japan cost gap, setting it lower than $1,000 on a typical small car, are impossible to support given the evidence at hand. With regard to the European producers, we estimate that although costs vary considerably among producers, the Japanese have a substantial, although lesser, cost advantage.

The simplest approach to estimation of cost differentials is to compare the average automotive value per unit as found in manufacturers' financial statements. This has been done in table 7.3, which compares automotive revenue, including parts sales, per unit exported by Toyota with the same measure for all production at Volkswagen, Ford of Germany, Ford North America, General Motors North America, and Ford and GM world wide. Toyota exports primarily it higher-value vehicles

Table 7.2
Primary operating cash flow of leading Japanese and American auto companies, 1973–1982 (millions of dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Honda	22	−42	−47	−57	20	−38	1122	9	167	−143
Nissan	nr	nr	nr	209	194	96	249	108	−5	n.d.
GM	2278	−173	1102	2831	2070	1179	−409	−4345	−5002	−699
Ford	368	−200	385	949	1026	360	−667	−2342	−1042	−1151

Notes:
n.r. = not reported in translation; n.d. = no relevant data available; "primary operating cash flow" = (net profit + depreciation) − capital spending. Yen have been converted to dollars at $1 = 215 yen.
Sources: Martin L. Anderson, "Financial Restrucuturing of the World Auto Industry," table 3; and calculations by the authors based on corporate annual reports.

Table 7.3
Estimated revenue per unit produced (vehicle and parts revenue divided by units produced), in current dollars

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Toyota (export vehicles)	2,245	2,377	2,472	2,434	2,567	3,270	3,814	4,049	4,235	4,238	4,688	4,823	nr
V.W. (excludes Audi)	2,450	2,745	2,944	3,326	3,775	3,492	4,513	4,899	5,322	5,859	6,427	7,030	7,363
Ford Germany	2,841	2,970	3,389	3,392	4,439	4,180	4,438	4,820	5,151	5,279	5,620	5,984	6,138
General Motors worldwide	3,107	nr	nr	nr	nr	nr	nr	5,672	6,221	6,895	7,488	8,634	9,077
General Motors N.A.	3,429	3,556	3,821	3,936	4,432	4,961	5,353	5,897	6,399	6,967	7,717	9,032	9,981
Ford worldwide	2,839	3,040	3,311	3,584	4,094	4,738	4,996	5,461	6,196	6,867	7,694	8,039	7,916
Ford North America	nr	nr	3,633	3,848	4,223	4,867	5,202	5,782	6,360	6,934	7,695	8,514	9,000
Production revenue per car, West Germany (VDA)	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	4,640	4,927	5,379	5,848	n.d.	n.d.
Average retail-transaction price of U.S.-produced cars sold in U.S. (BEA)	3,708	3,919	4,034	4,180	4,523	5,083	5,504	5,985	6,481	6,906	7,630	8,940	9,880

Notes: The revenues reported in this table are total motor-vehicle revenues, including revenues for replacement parts, divided by the total number of motor vehicles produced. For General Motors worldwide, Ford worldwide, Volkswagen, and Toyota's exported motor vehicles, these revenues are routinely reported in corporate annual reports (except that Toyota stopped this practice in 1982). In the case of GM's and Ford's North American operations these data are reported in some years but in other years only total corporate revenues (including aerospace and other non-motor-vehicle activities) are reported. To develop a continuous data series, the average ratio of motor vehicle revenues to total revenues in the years in which these figures are reported was multiplied by total corporate revenues in the years in which only this figure was available. Marks and yen were converted to dollars at $1 = 215 yen and $1 = 2.4 marks. The VDA data showing the average producer revenues per unit for the entire German industry are shown to provide a cross-check on the corporate data. Similarly, average retail-transaction prices for U.S.-produced cars sold in the U.S., as determined by the Bureau of Economic Analysis of the U.S. Department of Commerce, are shown as a cross-check on North American producers' revenues as reported in corporate statements. n.r. = not reported; n.d. = no relevant data available.
Sources: Corporate annual reports; VDA; BEA.

with high levels of trim and options, a mix which closely approximates the overall luxury level of vehicles sold in Europe and North America.

The results are striking, and make it difficult to argue that the U.S.-Japan cost differential is below $2,000 per unit or that the Europe-Japan cost difference is less than $500–700 per unit. These figures do not translate directly to a delivered cost comparison because Toyota incurs some distribution costs above the level in table 7.3 and because adjustments must be made for the small proportion of trucks in the GM and Ford North American production mix. However, these adjustments are quite small in comparison to the wide value differences reported in the financial statements.

There is, of course, much disagreement in the automotive world about the precise size of these differences in national production costs. However, one position advanced by a number of auto producers and unions is that, whatever the precise level of the cost difference, a major factor is improperly aligned currencies (particularly an overvalued dollar).[4] Therefore, it is important to ask whether currency values tend to outweigh other factors in determining the cost competitiveness of national auto industries.

Our belief is that they do not. The exchange rate used to convert the Japanese and German costs estimated in table 7.3 into dollars was 215 yen and 2.4 marks to the dollar. The mark/yen rate is roughly the level of the past two years, but the yen/dollar rate indicates a yen about 10 percent stronger than in the recent past, when the yen has hovered around 240. Thus, we have already made an adjustment to bring the yen/dollar rate closer to what we believe is a realistic long-term value, and this makes our estimate of the cost gap smaller than if it were calculated at the recent yen rate.

But what if the yen should strengthen to a level of around 185, which some observers in the auto industry have suggested is its proper long-term value? A simple reworking of the U.S.-Japan cost comparison in table 7.3 indicates that there would still be a substantial cost gap. With a yen at 185 to the dollar, Toyota's value in table 7.3 might rise by about $700 dollars. However, Toyota's factory prices are unlikely to rise to that extent because many items needed in Japanese production (including process energy to run the factory, practically all the raw materials in the vehicle, and a number of components manufactured by Toyota affiliates in East Asia) can be purchased by Toyota with non-yen currencies earned in profitable export sales. These transactions could largely mitigate the effects of a strengthening yen. Thus, the

increase in export prices is likely to be much less than directly proportional to the rate of yen appreciation. In short, it appears that restoring the competitive balance in the world auto industry would require a much stronger yen than any analyst of exchange rates has suggested is feasible.

If not primarily misaligned currencies, what is the basis of these cost differences? Unfortunately, a full cost accounting conducted by product line requires data that even auto producers lack in many cases and such data, when collected, are closely held proprietary information. However, it is apparent that a very large part of the cost of producing a car is accounted for by employment practices and compensation at all levels of the assembler and supplier firms. Government data make it possible to calculate an approximate Japanese-German-American comparison of these costs. The first step is to calculate the number of hours of effort by managers, designers, engineers, and production workers in the assembler and supplier firms needed to produce a roughly comparable vehicle (figure 7.1). The differences, as with total cost, are striking. The Japanese industry seems to have steadily reduced the amount of human effort needed to produce a car since 1970, even as the complexity of the vehicles being produced has risen. The Americans, in contrast, have been at roughly the same level of labor content per vehicle for many years if adjustments are made for the period after 1979 when volume fell off dramatically, increasing hours per unit in the short term. (These numbers must not be taken to mean, however, that productivity has not grown over time in the American industry. In fact, it has increased substantially because the vehicles being produced in 1981 were much more complex than the vehicles being produced in 1970.) In the early 1980s the Japanese producers needed only about 65 percent of the labor required in the American industry to produce a comparable product and about 30 percent fewer labor hours than the German auto producers on average. Like the cost data, these estimates incorporate assumptions—about vehicle mix, capacity utilization, and the comparability of government labor surveys—that rest on informed judgment rather than absolute knowledge. However, in general we believe that our assumptions produce conservative estimates of the difference in labor content between the Western and Japanese producers.

The second step in estimating employment cost per vehicle, which involves the multiplication of the average hours of labor per vehicle by the average cost per hour of compensation in the Japanese, German,

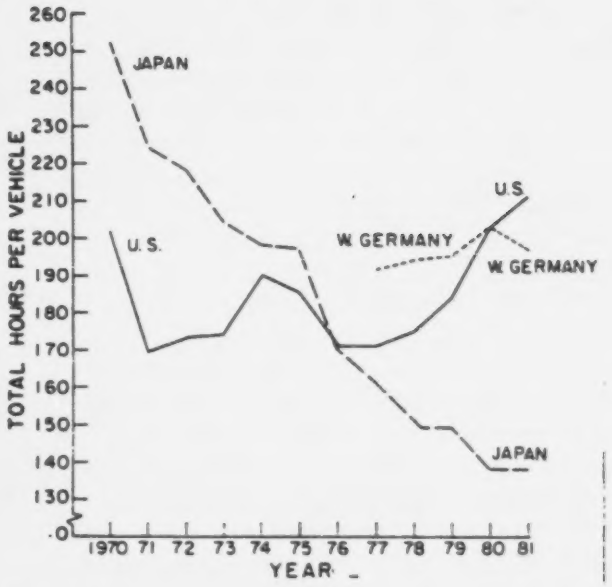


Figure 7.1
Total hours of employment to produce a motor vehicle, including management and production labor in the final assembler and supplier firms, in the American, Japanese, and German motor vehicle industries, 1970–1981.

The Japanese data include workers producing 6 million motorcycles and 400,000 automobile and light-truck export kits. Because these units are not included in the production total, the figure overstates Japanese employment hours per vehicle. The U.S. data include only workers in Standard Industrial Classification 371. Approximately 100,000 workers employed in automotive stamping operations are not included. Thus, the figure understates the employment hours in an American vehicle. The West German data include some workers producing exported parts which are assembled into finished vehicles in other countries. Because these vehicles are not included in the German production total, the figure tends to overstate employment hours in a German vehicle.

Sources: Japan, employment from Ministry of International Trade and Industry, *MITI Industrial Census*, Tokyo: MITI, various years; working hours per employee from Ministry of Labor, *Survey of Labor Statistics*; Germany, *Tatsachen und Zahlen aus der Kraftverkehrswirtschaft*, Verbank der Automobilindustrie (VDA), Frankfurt; United States, U.S. Department of Labor, Bureau of Labor Statistics

and American industries, is much more difficult. This is owing to differing forms of social compensation and the different combinations of management, technical, and production labor used in each industry. The employment hours in figure 7.1 are not comparable to the cost of production labor reported in table 9.6 because the hours in figure 7.1 include clerical employees not included in the hourly compensation cost estimates. Despite this difficulty, it is apparent that the difference in total employee cost per vehicle is large. Use of approximate hourly compensation estimates (based on table 9.6) indicates a U.S.-Japan employment cost difference per vehicle approaching $2000 and a German-Japanese difference roughly half as large. These employment cost differences roughly equal the total cost differentials estimated above. We believe, however, that there are other sources of comparative cost advantage for the Japanese in the area of processed materials such as steel and in lower capital costs per vehicle. The latter is not due primarily to lower capital costs in Japan but to the fact that Japanese producers seem to require much less plant and equipment per unit produced and to have much lower in-process inventories than the American and German producers.

As we have noted, these estimates are not precise, and we doubt that any comparative cost estimates can ever be developed for the world auto industry that do not have some margin of error. Nevertheless, the cost and labor-content gaps indicated are so large that different estimating techniques and assumptions are unlikely to change either the general magnitude or the trend.

With regard to the rest of Europe, we have found it difficult to make precise comparisons because of differences in national labor statistics and the financial reporting practices of producers. Our general belief, however, is that most European producers with relatively lower wage levels require larger amounts of labor per vehicle produced, with the result that their total employment costs do not differ substantially from the German averages. One or two lower-wage European producers may currently enjoy lower employment costs per vehicle, largely because of recent improvements in small car manufacturing technology and depressed national currency values, but these differences do not indicate long-term differences in cost of a fundamental nature.[5]

Thus, the Japanese approach to production organization establishes a new standard of best practice for the world. It supplants the old Ford system in the plant and the Sloan formula for coordinating the production chain as the recipe for competitive success. What is more, the

Japanese approach has applications not just in the auto industry but in all of mass manufacturing, as is illustrated by Japan's success in exporting motorcycles, consumer electronics, photographic equipment, construction machinery, and a host of other products.

Production Costs and Competition

What does this production-system advantage, expressed as a cost differential, mean in terms of competition among Japanese, American, and European auto producers? First, it is important to note that the estimates in table 7.3 cover only a small sample of producers. The gap between the most efficient American and European producers and the least efficient Japanese producers is far less than the gap between the least efficient American and European producers and the most efficient Japanese producers, which is truly enormous. Thus, the competitive implications differ for different producers.

Second, the Japanese producers have had a very large cost advantage over American and some European producers since at least the early 1970s and probably since the late 1960s. Their growth in world market share, however, has been a function of their range of product offerings, their production capacity, and the mix demanded by the market, as well as of production cost differences. In the U.S. market, the Japanese share jumped sharply during 1974–75 but then was reasonably stable until 1979, when it jumped again. The Japanese cost advantage seems to have widened only slowly during this period, indicating that market demand and product availability must be synchronized with production cost for a national industry to expand its world share. This suggests that in the future a cost gap of the present magnitude, especially when combined with high production accuracy and low delivered defects, will continue to convey a considerable competitive advantage. However, it can only be converted into increased market share if the model mix and specification demanded in the marketplace continue to correspond with the capability of the Japanese production system.

The effects of the Japanese cost advantage will vary with the type of producer. Specialist producers in Europe who offer products with unique performance or image may succeed in the world auto business, at least for the next decade, without having to match the Japanese in the area of production systems. The Western mass-market producers cannot take this position. They urgently need to improve their production systems.

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With regard to products, the competitive status of the Japanese industry is less clear. As explained in chapter 6, the development of automotive products is an art as well as a science that evolves over generations of vehicles. Until recently the Japanese producers devoted most of their export energy to light vehicles such as the Toyota Corolla and the Nissan Sentra. After three to four product generations, Japanese cars in this class have reached a very high standard of sophistication.

Because the Japanese makers are now facing unit limitations on their access to a number of important export markets, all have stepped up work on new medium and large cars, such as the Honda-BL Project XX, Toyota's Camry and next-generation Cressida, and the new, front-wheel drive Nissan Maxima/Bluebird. In addition, to cope with the intense domestic competition and the approaching saturation of the Japanese market, Japanese producers are attempting to differentiate their offerings within the light and small-car market segments with products such as the Honda City and CRX and the Nissan Prairie which shift competition from price to the special attributes of the product and which have the potential to increase the total size of the auto market as well. The consequence of this may be a shift by the Japanese producers from market followers to market definers in many classes. This would complete a historic shift in their image from lowest-cost producers to producers of high-specification products in every market segment. Such a transition by the Japanese would pose a special competitive problem for the European specialist producers, whose particular strength in the postwar era has been the development of distinctive products aimed at particular market niches.

Thus, the Japanese producers are strong in production systems and becoming stronger in products. Paradoxically, this has led to both a growing penetration of foreign markets and a growing vulnerability in market placement, the latter caused by restrictions on market access for fully built-up units. Japanese makers have concentrated on the export of built-up vehicles because the transfer of their production techniques to foreign sites is a major challenge in view of the great importance of physical concentration of the production process to facilitate just-in-time supply and tight system coordination.

Recently a move to foreign production has commenced in earnest. Honda and Nissan are now assembling cars and light trucks in the United States and increasing their percentage of domestic content. Nissan has agreed to build an assembly facility in Britain, eventually increasing the level of European content in the vehicles produced there

to 80 percent. Toyota has agreed to a joint venture with General Motors to assemble cars in California. The other Japanese producers are likely to establish manufacturing facilities in the United States and Europe to protect their competitive position, particularly if it appears that trade restraints will persist.

There is a large difference, however, between establishing a manufacturing facility in another country and returning a profit with that facility. It will be a decade or more before the success of these foreign ventures in producing superior products at competitive costs can be assessed.

Competitiveness of Western European Manufacturers

European auto designers in the postwar period have had a considerable advantage over the Americans and the Japanese with regard to products. In the United States a dominant very large design developed, while the Japanese specialized in light and medium cars (typified respectively by the Toyota Corolla and the Nissan Bluebird/Maxima). In addition, a single firm in the United States (GM) and two in Japan (Toyota and Nissan) were, until recently, the styling and design leaders in their respective industries. In Europe, by contrast, each national market emphasized (and continues to emphasize) a different dominant size of vehicle, ranging from small in Italy and France to large in Germany. In addition, there are many producers of roughly the same size and market power. The result has been that no single design philosophy or producer could dominate the market.

The different national market mixes were the result of isolation among the European markets before the late 1960s. There were sharp differences in vehicle taxation, degree of population concentration, purchasing traditions (fleet versus individual), driving conditions, and income levels. These factors led to four distinct dominant designs.

In France and Italy, high registration taxes on large cars and the concentration of population in large cities encouraged a very small dominant design. Initially very utilitarian (Citroen 2CV, Fiat 500), it gradually evolved into the standard small hatchback with the introduction of the Fiat 127 in 1971 and the Renault 5 in 1972. In Germany, taxation was neutral on vehicle size, but the dispersion of major population centers created a demand for intercity travel, aided by the autobahn system. The upper-income portion of the market settled on a dominant design in the Mercedes-Benz and BMW touring sedans, while

the lower-income market was defined by the VW Beetle. The Beetle was succeeded by the Golf in 1974, which prompted responses from Opel (Kadett, 1979) and Ford (Escort, 1980). In the United Kingdom the exemption of employee perquisites from personal income taxes created a company-car segment accounting for at least 45 percent of the market. Because these vehicles were justified by their business use, the dominant type became the medium-size "salesman's car." Ford Cortina designs from 1961 on typified this vehicle, now in its fifth generation with the Sierra (1982). Thus, each European nation's market developed around one or two dominant designs, and each national producer specialized in a dominant national type: Renault and Fiat in small cars, Volkswagen in light cars, Ford U.K. in the medium-size cars, and BMW and Mercedes-Benz in large touring cars. Figures 6.1 and 7.2 together show this tendency.

By the mid 1970s, formal trade barriers in the European market were eliminated. However, market integration has not altered the conditions that produced differences in national demand patterns. Differing designs are still dominant in each national market. The trend is for each major producer to offer a full range of models in all four segments, to specialize in the segment dominant in its home market, and to work very hard at maintaining its share in that market (figure 7.2).

Of particular importance has been the almost even division of the European market among six producers with market shares in the 10–15 percent range and a host of specialist producers in the 1–3 percent range (table 7.4). It has been quite impossible for a single producer to dominate the European market or for a single design philosophy to prevail. And at any given time, a wide range of models and national preferences protects the mass-market producers from dramatic demand shifts and presents a diffuse target for the Japanese volume producers.

An additional benefit to the European automakers of the lack of dominant producers has been the intensity of continuing experimentation with vehicle technologies in search of a competitive advantage. The smaller size of the specialist firms might have presented a problem, since they have limited resources to spend on research and development; however, this gap has been filled by independent supplier, design, and engineering companies (e.g., Bosch in complex componentry such as fuel injection, Bertone in design, and Porsche in engineering). The result has been the long-standing European competitive strength in product technology.

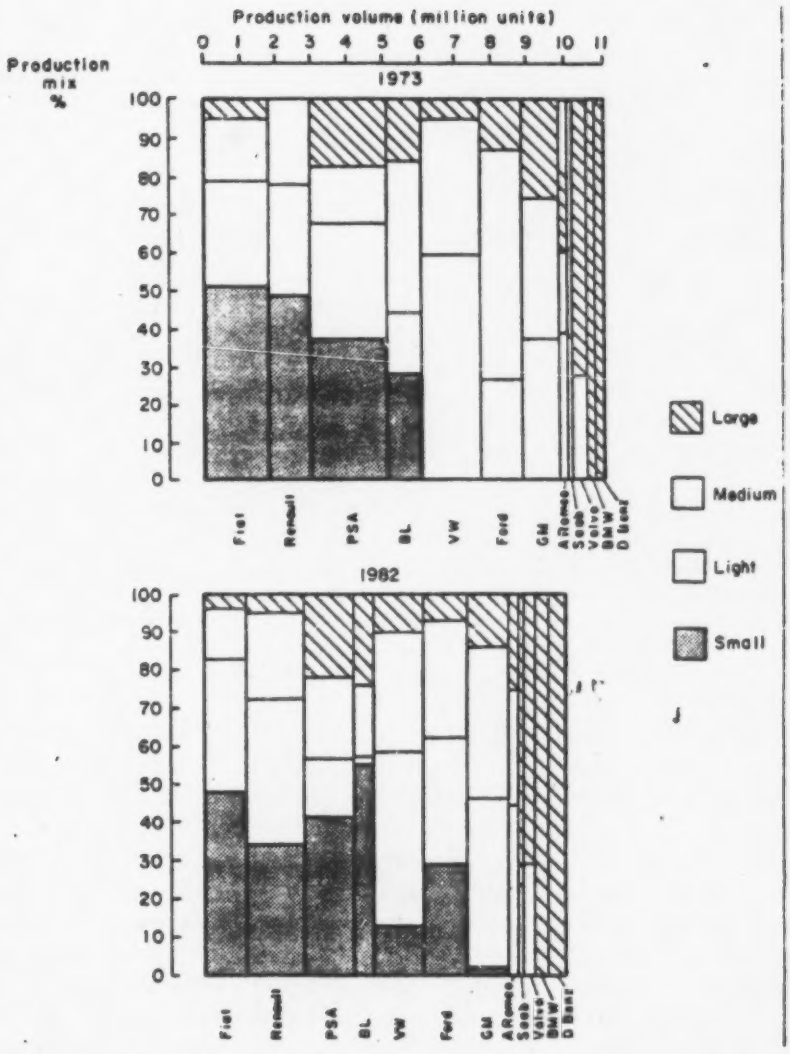

Figure 7.2
Production by European automakers by market segment, 1973 and 1982. Source: Jones, "SPRU Databank of the Western European Auto Industry."

Table 7.4
Producer market shares in Western Europe, 1979 and 1982

	1979	1982	Home-market sales/ European sales (1982)
GM	9.6	10.4	41.4
Ford	12.0	12.4	39.0
Volkswagen	12.1	11.8	52.4
Renault	13.4	14.7	55.7
PSA	17.3	12.4	51.0
Fiat	10.3	12.5	70.8
BL	4.1	3.7	75.9
Daimler Benz	3.0	3.2	72.1
BMW	2.5	2.8	46.7
Volvo	2.0	2.0	28.9
Alfa Romeo	1.8	1.8	58.9
Saab	0.6	0.6	49.2

Note: The "home market" is the country in which a producer is headquartered and makes the largest portion of its sales. In the case of General Motors (Opel) this is West Germany; in the case of Ford of Europe this is the U.K.
Source: SPRU Databank of the Western European Auto Industry

Whether the European technological edge can be kept sharp in the future is less certain. The Japanese producers have large financial resources, which they may invest in new product technology. Their new models are being marketed heavily on the basis of their technical attributes, such as Toyota's four-valve engine in the Supra and Mazda's electronically tunable suspension in the 626. Recent patent data, reviewed in another context in chapter 4, indicate an extraordinary upturn in Japanese patenting. In addition, Japanese producers are making use of the independent European design and engineering firms that have contributed to specialist technology in the past. For example, Toyota has bought an equity interest in Lotus, one of the most innovative automotive engineering firms.

Thus, the European lead in products may be challenged. It no longer resides in technical know-how protected by patents (since most of this knowledge is for sale to any producer), but rather in the art of putting advanced packages together harmoniously. If the Japanese were able to build automobiles with characteristics similar or identical to those of European specialist producers, they would probably be able to do it at much lower cost. However, to move successfully into the Audi

100 size segment and above represents a major leap from smaller vehicles, one that would probably take several product generations for the Japanese producers to accomplish. In addition, because the European producers realize the nature and importance of their advantage in this area, it seems certain that they will continue to invest heavily in R&D and product development, presenting foreign competitors with a moving target.

It is clear that product distinctiveness is the major competitive advantage of the European producers and that they will lose it only at great risk. In the small-car segment of the market (Fiat Panda, BL Metro, Ford Fiesta) and even more so in medium- and large-car segments, the lead has been retained and Japanese penetration has been low, even in open national markets. In the Golf/Escort/Kadett light-vehicle segment, however, the European product lead is gone; this is precisely where the Japanese producers have scored their greatest market successes. In the future, one strategy for the European producers will lie in stressing the diversity (even the nationalism) of their design philosophies and refusing to present a unified target to Japanese product designers.

The situation of the European-based producers is not only weaker with regard to market placement but also more complex to analyze because of the different situation of each producer in each of the national markets. Because the European national markets show little tendency to converge, are now mature in all but the southern countries, and permit exclusive dealing practices within the distribution network, it is apparent that intra-European shifts of market share will be very expensive to obtain. The market is saturated, with many producers offering products in each segment. Producers can expand into new territory only by establishing a new and independent sales network, because exclusive franchising prevents the "dualing" with established dealers which Japanese and European producers have used to advantage in entering the American market. Many products still retain a national flavor that endears them to home-country purchasers but repels export consumers. Therefore, dramatic shifts in the European producers' shares are unlikely. The stability of market shares has been high in the period since 1973; BL, PSA (the merger of Citroen, Peugeot, and Chrysler Europe), and Fiat have been the exceptions but they show strong signs of stabilizing.

It is evident that the Japanese automakers' share in Europe has now been stabilized by government pressures. The Japanese producers can

hope to grow mainly by increasing volume in periods of ebullient auto sales, by increasing revenue through sale of more luxurious models, or through local production with very high local content. Their future in Europe is therefore largely subject to political rather than commercial considerations.

In non-European markets the placement of European mass-market producers is generally poor. Finished-unit export volume has been severely eroded by the Japanese, and the efforts of various national producers to become multinational manufacturers on the GM/Ford model have so far been a cash drain rather than a source of strength.

Volkswagen has the most comprehensive world strategy. It supplies the less developed countries with kits from Brazil, serves Europe and the American "up market" from Germany, and goes after the American "down market" with U.S. assembly of components from Germany, Brazil, and Mexico. Although the prolonged economic slump in Brazil and Mexico and special problems in the United States have put the VW multinationalization program under pressure, in the longer run VW's very strong position in Brazil and Mexico may generate sufficient profits to make it one of the strongest multinational companies.

Renault has been the other European full-line producer with an energetic multinational strategy. Its foreign manufacturing operations are based in Spain, in Mexico, and in the United States through its buy-in to American Motors. The company's strategy, planned for the long run, will require heavy additional investments to produce a wider range of automobiles in the United States and integrate its Spanish operations into a European production network if Spain joins the EEC. Thus, it will be a number of years before the competitive consequences are known.

Otherwise the story of the European multinational automakers is one of failure. BL retrenched from its foreign commitments in the 1970s. Peugeot has never really left home. Fiat has ventured the most and lost the most, having failed at rationalizing SEAT (its licensee in Spain), at buying into Citroen, at producing profitably in Brazil, at establishing a continuing presence in Eastern Europe, and at developing a North American distribution system. Thus, except for VW and Renault, the European full-line producers are for the period under study just that: European producers.

The European specialists, by contrast, have had remarkable success in capturing top-of-the-line markets across the world through sales of finished units shipped from their domestic production bases. They have

even had some success in Japan. Daimler-Benz, BMW, Volvo, and Saab (soon to be joined by Jaguar as it is split off from BL) are currently claiming substantial price premiums in most export markets outside of Europe. This strengthens them competitively within Europe as well. Eventually, however, they are certain to face a strong Japanese challenge and an American counterchallenge for these lucrative markets. This is particularly so in the case of the Japanese, because the typical current practice of expressing trade restrictions in units gives Japanese producers a strong incentive to shift their product mix to garner more revenues per unit and perhaps larger profit margins.

With regard to production systems, the European producers divide into three categories. One group of mass-market producers, consisting of BL, PSA and Fiat, is in the process of catching up with European best practice in production systems. They must still complete the rationalization of their production systems and deal with overmanning in some facilities. PSA and BL mostly need additional rationalization in the components sector, where large numbers of small suppliers must be realigned to match the rationalization of the final assembly operations now nearly completed after a long period of mergers. In the case of Fiat and BL, labor-relations deadlocks have recently been broken to permit manning at levels much nearer, although still above, the European average.

A second group of full-line producers—Ford, GM, VW, and Renault—have attained the best production practice in Europe, including a high level of production reliability and accuracy as well as integrated trans-European production systems, but lag behind the Japanese in manning levels and in-process inventories per unit of production. Only if this gap is closed will these makers be competitive in export markets outside of Europe and in the European fringe markets, which remain relatively open to the Japanese producers. This process requires a very large amount of organizational learning, which will take a number of years.

The third group of European producers, the five specialists, have generally attained a high level of production reliability and accuracy after some lapses in the 1970s. They do not for the moment have to match Japanese manning and inventory levels, because they are competing more on product attributes than on price.

In view of the social constraints on European producers in workforce reductions and wage levels, as illustrated in chapter 9 and appendix C, it is not surprising that they look to flexible manufacturing technologies to close the productivity gap. Volkswagen, Renault, and Fiat

are world leaders in flexible manufacturing technology and hope to develop profitable businesses by serving other auto producers with products developed initially for their own needs.

The Competitiveness of American Manufacturers

Auto production in the United States was severely threatened by the combination of the extreme slump in the auto market during 1979–1982 and a shift in product demand that caught the American producers out of phase while Japanese and European rivals were well positioned. More ominous, the U.S. production system was shown to be broadly deficient in cost and precision, even with the return of a strong market and with an improved mix of product sizes.

Perhaps the key competitive strength of the American industry lies in market placement. The traditional size difference between North American cars and those of the rest of the world continues. Nearly one third of 1982 car sales in North American were in the very large size class which the rest of the world's producers (except Rolls-Royce and Daimler-Benz) do not serve.

The "very large" class will remain a source of competitive strength for U.S.-based production, because the Japanese in particular would be taking an unacceptable risk in developing large production capacity in Japan for a product that could be sold only in North America. In addition, it would take several product generations to reach the American level of sophistication in this class, where the American product is truly distinctive after more than 30 years of development. After 1979, many observers of the industry wrote off this segment as a casualty of higher energy prices. However, the American manufacturers, after a trip to the technology shelf, applied a number of short-term technical fixes for excessive fuel consumption to subtly downsized but still very large automobiles. In 1983 and 1984, North American sales of these more economical "very large" cars have been strong.

Because the American-based manufacturers are continuing to refine fuel-efficient drive trains and bodies and have the ability to quickly shift the drive train mix toward increased fuel efficiency, they should be able to defend volume in this segment if energy prices rise again. Also, they have not yet taken full advantage of the technologies available, such as diesels with turbochargers and lock-up torque converters combined with lighter front-wheel-drive layouts of the same general external dimensions. Thus, the unexpected durability of the "very large"

market segment gives the North American producers some breathing room in meeting the extreme challenges presented them at the small-car end of the market.

A second aspect of American market placement that confers a competitive advantage (although not to the extent that many observers believed prior to 1979) is the location of American-owned production around the world and the existence of a broad range of products at these other production locations. In two previous crises in the North American industry—the market slump and European import surge of 1958–59 and the initial Japanese success in the American market at the end of the 1960s—the American producers were able to import products from Europe while new domestic designs were being readied. This plugged gaps in their product lines, maintained their market share, sustained cash flow, and discouraged their dealers from taking on import franchises. However, this path was blocked in the 1979–1982 crisis by the lack of extra production capacity in Europe, the lack of a Japanese production base, and regulatory complications in the United States.

There are two major regulatory impediments to substitution of foreign-built products in response to demand shifts in the United States toward market segments not adequately covered by domestic products or production capacity. One is the need to "federalize" vehicles for the U.S. market in terms of emissions and safety. The other is the need to meet the Corporate Average Fuel Economy (CAFE) standards, which calculate a producer's fuel-economy average for domestic and import production separately. Because federalizing vehicles for safety adds about 200 pounds and considerable cost, producers are reluctant to federalize foreign products for the remote contingency that they may be demanded in the United States at some point. Similiarly, developing an engine able to meet the U.S. emission standards is an expensive process that adds cost to the base engine even if the catalysts and other bolt-on items are left off products produced for other markets. In consequence, when foreign products were needed in the United States after 1979, many potential entrants were disqualified by high conversion costs. Just as serious was the fact that the models most demanded were in the small- and light-car segments. American manufacturers reasoned that their fuel-efficient imports would partially displace their fuel-efficient domestic products, leaving the manufacturer's U.S. output with too high an average fuel consumption to meet the government's fuel-economy regulations.

The main benefit the American multinational automakers gained from their worldwide production organizations, therefore, was financial. Foreign sales did not slump nearly as much as American sales, so the foreign subsidiaries were able to provide substantial financial assistance to their parent companies. For example, Ford of Europe loaned its North American parent more than $1.0 billion dollars. Without this aid the American producers would have had to slow the pace of new product introductions and this would have had serious longer-term consequences for domestic sales.

The rest of the market placement of the American industry is, on balance, a weakness, even with the naturally protected very-large-car segment because of the peculiarities of the North American market. Because this is the world's most mature and volatile market, it is risky for any producer to have it as a primary market. In addition, it is the world's easiest market for foreign producers to enter because of the organization of the American retail distribution system. In Europe and Japan retailers are either owned by the final assembler or tied tightly through "exclusive dealing" agreements which stipulate that a dealer may sell only the manufacturer's products or face the loss of his franchise. In the United States, court decisions in the late 1940s outlawed exclusive dealing clauses in franchises. Since that time a simple strategy for foreign producers wishing to enter the U.S. market has been to sign up established dealers who wish to expand and cannot obtain additional franchises from domestic producers or who are experiencing trouble in maintaining sales volumes with their existing lines. For example, Isuzu and Mitsubishi were recently able to establish dealer networks in the United States mostly by "dualing" with Ford, GM, and Chrysler dealers worried about declining sales of domestic products. They did this in a very short period of time and without major investments.

Yet another market placement problem for North American producers involves the introduction of new products. Any new product from any world manufacturer will experience some unanticipated problems in its first months of consumer use. However, the North American producers release new products directly into their primary market where they must compete against European and Japanese products which invariably have undergone a period of "consumer proving" in their home market before the commencement of exports. This situation obviously magnifies any quality problems the North American producers may have and works to the benefit of Japanese producers in particular,

who face little foreign competition in their home market during the "proving period" and who then export more than half of their total output.

The competitive situation of the American manufacturers in regard to products is precarious outside the "very large" segment. Historically, the entire industry was vulnerable to the weakness, often ascribed to Henry Ford and Volkswagen, of sticking with a dominant design past its time. The designs in the "very large" segment proved difficult to scale down quickly or to reconstitute as competitors to European luxury models. They carried an image of retrograde technology: rear drive, separate chassis and body, and simple suspensions adequate to the very soft "boulevard" ride Americans once preferred. With such vehicles it was easy, as product demand shifted, for the American producers to lose not only volume but, perhaps more important, image leadership that also affected the "light," "medium," and "large" market segments.

American producers are now imitating the Europeans in designs for sporty and touring/luxury versions of mass-market models and imitating the Japanese in designs emphasizing economy and utility. The result is that the traditional American domination not only of the volume but also of the spirit and style of the domestic market is now greatly weakened.

The American production systems are also an area of competitive disadvantage. The differences from the Japanese system are apparent in labor relations, production organization, supplier relations, and financial resources.

Financial constraints pose a particular problem because a long time is required for social learning in organizations the size of auto-production systems. As discussed in chapter 6, these large organizations are collections of innumerable skills, ways of conceptualizing problems, and accommodations for working collectively. When old approaches are suddenly inadequate to new conditions, the initial response of denial of the problem is often followed by chaos as different solutions and programs of action vie for supremacy. This characterizes the response of the American producers since 1979. First they needed to get new models into production because of the mismatch between the pre-1980 models and the post-1979 market. Only when this was well in hand did it become apparent that the new models had no technical or design superiority over the imports that would allow them to compete on attributes other than price. It also became apparent that American production organization, manufacturing costs, and assembly accuracy, after decades of effective market isolation by virtue of cheap energy, had

developed without reference to world trends and were well out of line with the Japanese and in some cases with the Europeans.

Substantial reforms are underway, encouraged by the initiation of production in the United States by Honda and Nissan and by the General Motors–Toyota joint venture. Developments within the established domestic production organizations, such as the "Buick City" complex and the new manufacturing system for the Pontiac Fiero, are encouraging as well. However, a full reworking of the production system cannot be achieved in a short period. The whole work force (including middle managers, engineers, and production workers) must be retrained in new organizational approaches, and production facilities must be concentrated in a few geographic areas to permit full use of the just-in-time method and other improved methods of inventory and quality control. The Japanese, it must be remembered, needed nearly 20 years to create their present system.

Revitalization of the industry on this scale requires enormous financial resources over a long period of time and, no less important, a capacity in the financial system for independent and informed criticism. The American financial system is not well suited to either task, and American government intervenes only as a financial source of last resort after companies have already sustained a great deal of damage. Thus, the outlook for the American industry to reestablish a competitive balance is uncertain.

The Competitiveness of Locales Outside the OECD Countries

The Less Developed Countries

The evidence is that there is a marked competitive imbalance among the seven Auto Program countries. But does a more important competitive imbalance lie outside the developed world? Product-cycle theories suggest that, because the auto industry is now mature in many market segments, with competition largely on price, and because production techniques are well understood and at least potentially transferrable, auto production ought to be shifting to less-developed countries where wages are low. Is it possible, particularly if competitive pressures push the multinational auto producers in this direction, to build automobiles for many developed-country markets more cheaply in the LDCs?

A wholesale transfer is not possible now and is unlikely to occur soon. The main obstacles are the complexity of the motor vehicle as a consumer good and the vast scale of the world industry. Producing a simple item in moderate volume in an LDC for its domestic market is one matter; making millions of units of a complex product in an LDC for shipment halfway around the world to a sophisticated OECD market is another. So far, none of the multinational auto producers has been able to do this and no indigenous producers have arisen or seem likely to arise in the LDCs to do it in their stead.

But what about components? If the complex process of putting all the parts together is best done in the OECD countries, where design activities and overall production coordination take place, is it possible that most components could be produced more efficiently and with adequate quality in the LDCs?

Auto components can be divided into three types in terms of their suitability for production in LDCs.* Major mechanical components, notably engines and transmissions, require heavy initial investments and are highly automated with low amounts of direct labor. "Finish" parts, such as exterior body stampings, seats, and dashboard moldings, are bulky to ship and must fit very precisely. In addition, it is critical that their finish quality and color precisely meet specifications. Minor mechanical components, including starters, radiators, springs, and wiring harnesses, require much simpler manufacturing techniques.

Major mechanicals require technically skilled labor to run the complex plant equipment. In addition, the size of the investment and the importance of uninterrupted supply make political and economic stability, often termed "country risk", an important factor in location. Thus, only a few sites in low-wage areas are suitable. In Korea, the most favorable of these areas, a cost saving of about 20 percent could be achieved on engines (as of 1980) by American-based producers after shipping and additional inventory costs are taken into account. This is a significant saving, to be sure, although not nearly so large as one might have expected. However, the more important fact about Korean production costs is that they are probably above Japanese costs and it is not apparent that any low-wage site can now produce major mechanicals more cheaply than Japan. This is because the Japanese producers have made such progress in reducing the total labor hours needed for engine and transmission manufacture that their higher wage costs per hour are more than offset.

"Finish" parts are expensive to ship because of their bulk, and producing them at remote locations creates great quality control problems. Indeed, the remote sourcing of these parts runs against the strong desire of most automakers to centralize production at the point of final manufacture.

Minor mechanicals are the components best suited to low-wage sourcing. As of 1980, starter motors could be manufactured in Korea and delivered to Detroit for 35 percent less than they would cost to manufacture in Detroit. The saving on wiring harnesses made in Mexico was 25 percent. (Mexico was the lowest-cost site for delivery to Detroit because of the relative bulk of harnesses and the greater shipping cost from Korea or Taiwan.) However, LDC costs are currently no lower than Japanese costs except for a few items, and minor mechanicals are also the components most suited to automated manufacture as flexible manufacturing systems achieve the "seeing and feeling" capabilities needed for automated machining and assembly of parts.

In sum (see table 7.5), only a small advantage can be gained at present through sourcing in low-wage areas and the number of components on which costs can be saved is likely to decline as OECD factories are more highly automated and OECD production systems are more tightly centralized. This does not mean that the LDCs have no potential for automotive exports to the OECD countries, but rather that their often-assumed competitive advantage, based on low unit labor cost, does not shift the competitive balance away from the developed countries. The need to achieve scale economies in developing countries with high local-content requirments, coupled with the feasibility of building highly automated plants in those countries which can produce at an adequate standard of quality, means that some OECD production is being transferred from the United States and Europe to developing countries such as Mexico, Brazil, and Korea. For different reasons, some Japanese production may be transferred also. For example, General Motors is reportedly considering a plan to assemble Japanese components into finished units in Korea for sale in the United States. This arrangment would preserve most of the Japanese advantage in production cost while skirting the present U.S. unit limitation on Japanese imports. Ford and Toyo Kogyo have recently announced a similar plan for a new assembly plant in Mexico which will send its output to the United States. Clearly, the main aim of such transfers is not to produce cost savings for multinational producers in the OECD markets; rather, it is to gain access to developing and developed markets. Fur-

Table 7.5
Cost savings in U.S. auto manufacture from remote sourcing of auto components in low-wage countries (1980)

Component	Labor cost saving	Additional shipping cost	Net saving	Net saving/ value added	Cheapest country
Engine	$89.00	$44.00	$45.00	20%	Korea[a]
Transmission	55.00	21.00	34.00	29%	Korea[a]
Body stampings (set)	90.00	64.00	26.00	12%	Mexico
Starter motor	3.03	1.65	1.38	35%	Korea
Radiator	.97	1.14	−.17	—	Mexico
Coil spring	1.61	1.41	.20	6%	Mexico
Wiring harness	1.00	.59	.41	25%	Mexico

Notes:
a. These components are cheaper when sourced in Korea than in the United States but not necessarily cheaper than when sourced in Japan. Japanese wages are much higher than Korean, but total labor (direct plus indirect) is probably much lower.
Source:
Derived from published and unpublished data including Rath and Strong, Harbour and Associates, U.S. Department of Transportation, Transportation Systems Center, and company data.

thermore, the magnitude of these transfers, though it has grown in recent years, is tiny as a fraction of total world production.

The Eastern Bloc

A different situation is presented by the Eastern bloc, where governments are able to set wage and exchange rates to produce an industry that seems "competitive" in some OECD markets. The Eastern Europeans attracted attention in the late 1960s and the early 1970s with plans to enter world auto competition by buying the previous generation of auto tooling from Western producers and using it to export vehicles aimed at the lowest-cost, basic transportation segment of the European and North American auto markets. The program ran according to plan initially, after Fiat's sale to the Russians of production technology for its 124 line. Eastern bloc exports to the West rose from 60,000 per year in 1973 (mostly Skodas and other indigenous East European designs) to 149,000 in 1979.

Prospects for further growth of these exports have been dealt a heavy blow by the poor recent performance of the Eastern economies and

the fact that they have reached the upper limit of borrowing from Western bankers. In consequence, the only way the Eastern European industry can pay for the next generation of auto technology is through the barter of finished vehicles or components.

Fiat is receiving some cars and components as partial payment for transfers of technology, but the failure of the Oltcit venture with Citroen in Rumania has cast doubt on the barter principle. Citroen offered designs and tooling for a current-generation model to Rumania's state-owned motor company in the hopes of recouping its investment in a model no longer needed after its merger with Peugeot and developing an Eastern European foothold at the same time. Payment was to be in the form of 30,000 finished vehicles, which PSA would retail in Western Europe. The exchange has been blocked, however, by the inability of the Rumanian firm to produce vehicles to PSA's minimum standard of quality. (The same problem was mentioned earlier in connection with LDC production of fully built-up automobiles.)

With PSA unpaid, the idea of bartering auto technology for finished cars is understandably receiving a critical reexamination in the West. As a result, the Eastern Europeans are being forced to sell increasingly outdated products at lower and lower prices, particularly since they must now compete against low-priced Japanese products of very high quality in the low end of the European market.

Only the Russians are going ahead with a new auto generation aimed at export markets, a front-drive Lada successor designed by Porsche in return for cash payment. However, the ability of the Russians to go forward rapidly in vehicle production seems to be constrained by operating problems at the Kama River truck plant. The familiar Russian difficulty with running massive industrial complexes on the Leninist industrial model seems in this case to be soaking up the whole of available spending for the vehicle sector, delaying the new Lada into the next plan, which commences in 1985. Some additional export success can be expected for Lada's four-wheel-drive Niva model, which is tailored to cold climates. In general, however, the Eastern Europeans are not likely to offer a competitive threat in the OECD marketplace during the next 20 years.

A Major Competitive Imbalance Among the Developed Countries

What may be concluded about the state of competition within the automotive world? First, there is a competitive imbalance between the

developed countries and the rest of the world, but it favors the most competitive among the developed countries. Second, the major competitive imbalances among the Auto Program countries, favoring the Japanese producers, are currently very large in many market segments. They create extreme pressures for restructuring and rebalancing, which will be the major force driving the development of the world auto industry over the next 20 years.

EXHIBIT A. DOMESTIC AND IMPORTED MOTOR VEHICLE TAXES: SUMMARY

--TAXES PER VEHICLE--

	DOMESTIC	JAPANESE IMPORT
WHOLESALE DISTRIBUTION*	**	$ 150
IMPORT DUTY	N/A	330
OE MANUFACTURER:		
Income Taxes	$ 182	193
Other Taxes	344	54
RELATED SUPPLIERS:		
Income Taxes	126	170
Other Taxes	291	107
TOTAL TAX BURDEN	$ 943	$1,004
ESTIMATED AVERAGE WHOLESALE VALUE PER VEHICLE	$10,247	$7,292
TOTAL TAX BURDEN AS A PERCENT OF VEHICLE VALUE	9.2%	13.8%

*See following page for explanation of categories

**Included in OE manufacturing

N/A Not applicable

EXHIBIT A. (Continued)

EXPLANATION OF TAX CATEGORIES:

- WHOLESALE DISTRIBUTION: Income, payroll, property and other taxes paid by the companies that import and distribute Japanese vehicles in the United States
- IMPORT DUTIES: A tariff, or import tax, levied on each vehicle imported into the United States
- OE MANUFACTURER INCOME: National and sub-national taxes on income paid by the companies that complete the assembly of the vehicles
- OE MANUFACTURING OTHER: Non-income taxes (payroll, property, etc.) paid by the companies that complete the assembly of the vehicles
- SUPPLIER INCOME: National and sub-national taxes on income paid by the companies that provide parts and component systems to the OE manufacturers
- SUPPLIER OTHER: Non-income taxes (payroll, property, etc.) paid by the companies that provide parts and component systems to the OE manufacturers

EXHIBIT B. COMPARISON OF INDIRECT ASSOCIATED TAXES: SUMMARY

--TAXES PER VEHICLE--

	DOMESTIC	JAPANESE IMPORT
DISTRIBUTION EMPLOYEES*	**	$ 39
OE MANUFACTURING EMPLOYEES*	$ 747	71
SUPPLIER EMPLOYEES*	490	117
TOTAL DIRECT AND INDIRECT ASSOCIATED TAXES AS A PERCENT OF AVERAGE WHOLESALE VALUE OF VEHICLE	21.3%	16.9%

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* National and sub-national income taxes and social security contributions paid by employees involved in the manufacture and distribution of the vehicle. For imports, wholesale distribution refers to employees of the U.S.-based firms that import and distribute Japanese vehicles.

**Included in OE Manufacturing

DOMESTIC AND IMPORTED MOTOR VEHICLE TAXES:

GUIDE TO SUPPORTING TABLES

	DOMESTIC	JAPANESE IMPORT
DIRECT		
Wholesale Distribution	*	Table 7
Duties	N/A	Table 8
OE Manufacturing Income	Table 1	Table 9
OE Manufacturing Other	Table 2	Table 10
Supplier Income	Table 3	Table 11
Supplier Other	Table 4	Table 12
(Estimated Wholesale:	Table 16a	Table 16b)
INDIRECT ASSOCIATED		
Distribution Employees	*	Table 13
OEM Employees	Table 5	Table 14
Supplier Employees	Table 6	Table 15

*Included in corresponding OEM categories
N/A: Not applicable

TABLE 1. DOMESTIC WHOLESALE/OE MANUFACTURING INCOME TAXES*

BASIC CALCULATION:

- 1983 GM/Ford weighted-average U.S. automotive revenues per vehicle sold x 7-year inflation-adjusted GM/Ford weighted-average pre-tax profit as a percent of sales for U.S. total operations** x 7-year inflation-adjusted GM/Ford weighted-average effective tax rate

SUPPORTING TABLES:

- Table 1a. Domestic OE Manufacturers: Dollar Sales
- Table 1b. Consumer Price Index-All Urban (CPI-U)
- Table 1c. Domestic OE Manufacturers: Pre-Tax Profit
- Table 1d. GM: U.S. Operations Pre-Tax Profit
- Table 1e. Ford: U.S. Operations Pre-Tax Profit
- Table 1f. 7-year Inflation-adjusted GM/Ford Weighted-average Pre-Tax Profit as a Percent of Sales
- Table 1g. Domestic OE Manufacturers: U.S. Income Taxes
- Table 1h. 7-year Inflation-adjusted GM/Ford Weighted-average Effective Tax Rate
- Table 1i. Estimation of 1983 Ford U.S. Automotive-Related Revenues
- Table 1j. 1983 GM/Ford Weighted-average Revenues Per Vehicle
- Table 1k. Domestic Wholesale/OE Manufacturing Income Taxes

*Not possible to separate distribution from manufacturing via general publicly-available information (i.e. Annual Reports, 10-K).

**Assumes Pre-Tax Profit Margins are the same for U.S. Automotive as for U.S. Total. Made necessary because unable to derive Pre-Tax Profit figures solely for U.S. Automotive operations.

TABLE 1a. Domestic OE Manufacturers: Dollar Sales ($ millions)

	GENERAL MOTORS			FORD		
YEAR	Worldwide	U.S.	U.S. Constant Dollars(1)	Worldwide	U.S.	U.S. Constant Dollars(1)
1983	$74,581	$66,162	$22,172	$44,454	$33,107	$11,094
1982	60,025	50,323	17,407	37,067	24,274	8,396
1981	62,698	52,753	19,366	38,247	23,482	8,620
1980	57,728	46,924	19,013	37,085	21,882	8,866
1979	66,311	55,014	25,305	43,513	28,191	12,967
1978	63,221	53,498	27,379	42,784	31,019	15,874
1977	54,961	47,551	26,198	37,841	27,762	15,295
TOTAL			$156,843			$81,115
TOTAL GM/FORD:				$237,958		

(1) Adjusted using Consumer Price Index-All Urban Consumers (CPI-U), 1967=100; as per both GM and Ford Annual Reports. See Table 1b.

Source: GM/Ford Annual Reports.

Table 1b. Consumer Price Index-All Urban (CPI-U) 1967=100

YEAR	INDEX	100/INDEX
1983	298.4	.3351206
1982	289.1	.3459010
1981	272.4	.3671071
1980	246.8	.4051863
1979	217.4	.4599816
1978	195.4	.5117707
1977	181.5	.5509641

NOTE: This is the inflation adjustment used by both GM and Ford in their Annual Reports.

Source: (1977-1982) Business Statistics 1982 U.S. Department of Commerce, Bureau of Economic Analysis: A Supplement to The Survey of Current Business; p.24.

(1983) Survey of Current Business U.S. Department of Commerce, Bureau of Economic Analysis, May 1984, p.S-5.

Table 1c. Domestic OE Manufacturers: Pre-Tax Profit ($ millions)

	GENERAL MOTORS			FORD		
YEAR	Worldwide	U.S.	U.S. Constant Dollars(1)	Worldwide	U.S.	U.S. Constant Dollars(1)
1983	$4,971	$4,387	$1,470	$2,166	$1,191	$ 399
1982	23	170	59	(408)	(1,447)	(501)
1981	(138)	289	106	(1,138)	(1,615)	(593)
1980	(1,368)	(928)	(376)	(1,980)	(2,798)	(1,134)
1979	4,857	4,032	1,855	1,509	(890)	(409)
1978	6,343	5,989*	3,065	2,778	1,107	567
1977	6,049	5,779*	3,184	3,002	1,687*	929
TOTAL			$9,363			$(741)
	TOTAL GM/FORD:			$8,621		

Note: Pre-Tax Profit as reported in GM/Ford Annual Reports. Does not include equity in earnings of non-consolidated subsidiaries or associates.

Source: GM/Ford Annual Reports.

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*U.S. only pre-tax profit not reported for these years. Estimated as U.S. after-tax profit divided by the ratio of worldwide after-tax profit to worldwide pre-tax profit for the same year. See Tables 1d and 1e.

Table 1d. GM: U.S. Operations Pre-Tax Profit ($ millions)

YEAR	WORLDWIDE PRE-TAX PROFIT	WORLDWIDE AFTER-TAX PROFIT	U.S. ACTUAL PRE-TAX PROFIT	U.S. AFTER-TAX PROFIT DIVIDED BY WORLDWIDE PAT/PBT*
1983	$4,971.5	$2,747.7	$4,387.6	$6,276.7
1982		NOT MEANINGFUL		
1981		NOT MEANINGFUL		
1980		NOT MEANINGFUL		
1979	4,857.8	2,674.4	4,032.3	4,215.0
1978	6,343.5	3,255.0	N/A	5,989.2
1977	6,049.6	3,115.4	N/A	5,779.2

NOTE: As 1977-1978 U.S.-Only pre-tax profit figures are not reported in the 1977-78 Annual Reports, as are more recent figures, this estimate was made; assumes that ratio of profit before tax to profit after tax is the same for U.S. and Corporate Total. Based on the available sample for comparison of 1979 and 1983, this assumption will OVERSTATE GM's U.S. Pre-Tax Income.

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*Profit After Tax Divided by Profit Before Tax

N/A=Not Available

NOT MEANINGFUL: Pre-Tax Loss (either U.S., worldwide or both) in that year

Table 1e. Ford: U.S. Operations Pre-Tax Profit ($ millions)

YEAR	WORLDWIDE PRE-TAX PROFIT	WORLDWIDE AFTER-TAX PROFIT	U.S. ACTUAL PRE-TAX PROFIT	U.S. AFTER-TAX PROFIT DIVIDED BY WORLDWIDE PAT/PBT*
1983	$2,166.3	$1,896.1	$1,190.0	$1,359.6
1982		NOT MEANINGFUL		
1981		NOT MEANINGFUL		
1980		NOT MEANINGFUL		
1979		NOT MEANINGFUL		
1978	2,778.7	1,630.7	1,107.6	1,887.3
1977	3,002.0	1,676.4	N/A	1,686.9

NOTE: As 1977 U.S.-Only Pre-Tax Profit figure is not reported in the Ford Annual Reports, as are more recent figures, this estimate was made; assumes that ratio of profit before tax to profit after tax is the same for U.S. and Corporate Total. Based on the available sample for comparison of 1978 and 1983, this assumption will OVERSTATE Ford's U.S. Pre-Tax Income.

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*Profit After Tax Divided by Profit Before Tax

N/A=Not Available

NOT MEANINGFUL: Pre-tax loss (either U.S., worldwide or both) for that year

Table 1f. Seven-Year Inflation Adjusted GM/Ford Weighted-Average Pre-Tax Profit As A Percent Of Sales (U.S.)

- Equals $\frac{\text{7-Year Total GM/Ford Pre-Tax Profits (U.S.)}}{\text{7-Year Total GM/Ford U.S. Dollar Sales}}$

$$= \frac{\$8,621.5}{\$237,958.3} = 3.62\%$$

- Additional Profitability Information.....PBT/Sales:

	GENERAL MOTORS			FORD		
YEAR	WORLDWIDE	U.S.	U.S. CONSTANT DOLLARS	WORLDWIDE	U.S.	U.S. CONSTANT DOLLARS
1983	6.66%	6.63%	6.63%	4.87%	3.60%	3.60%
1982	0.04	0.33	0.33	(1.10)	(5.96)	(5.96)
1981	(0.22)	0.54	0.54	(2.97)	(6.88)	(6.88)
1980	(2.37)	(1.98)	(1.98)	(5.34)	(12.79)	(12.79)
1979	7.32	7.33	7.33	3.47	(3.16)	(3.16)
1978	10.03	11.26	11.26	6.50	3.57	3.57
1977	11.01	12.27	12.27	7.93	6.08	6.08
Weighted-Average	4.71%	5.32%	5.97%	2.11%	(1.46)%	(0.91)%

GM/FORD WEIGHTED AVERAGES:

--Worldwide: 3.65%
--U.S.: 3.03
--U.S. Constant Dollar: 3.62

Table 1g. Domestic OE Manufacturers: Income Taxes ($ millions)

	GENERAL MOTORS			FORD		
YEAR	CURRENT(1)	TOTAL(2)	TOTAL IN CONSTANT DOLLARS	CURRENT(1)	TOTAL(2)	TOTAL IN CONSTANT DOLLARS
1983	$ 380	$1,811	$ 607	$ (58)	$ (75)	$ (25)
1982	(177)	(278)	(96)	(168)	(168)	(58)
1981	484	(122)	(45)	(306)	(306)	(112)
1980	(345)	(600)	(243)	(665)	(629)	(255)
1979	1,707	1,882	865	(201)	(560)	(258)
1978	2,559	2,534	1,297	439	302	155
1977	2,761	2,594	1,429	607	587	322
TOTAL	$7,371	$7,821	$3,814	$ (352)	$ (849)	$ (230)

Seven-Year Inflation-Adjusted GM/Ford Total Income Taxes = $3,584.8

(1) Current: Currently Payable (Refundable) U.S. Federal, State and Local Income Taxes

(2) Total: Current Plus Deferred U.S. Taxes and Net Investment Tax Credit

Source: GM/Ford Annual Reports

Table 1h. Seven-Year Inflation-Adjusted GM/Ford Weighted-Average Effective Tax Rate

- Equals $\frac{\text{Seven-Year Inflation-Adjusted GM/Ford Total Taxes}}{\text{Seven-Year Inflation-Adjusted GM/Ford PBT}}$

$$= \frac{\$3,584.8}{\$8,621.5} = 41.6\%$$

Table 1i. Estimation of Ford's 1983 U.S. Automotive-Related Revenues ($ millions)

YEAR	WORLDWIDE CONSTANT $	WORLDWIDE CONSTANT $	WORLDWIDE AUTO/TOTAL	ESTIMATED U.S. AUTO(1)(2)
1983	$14,897	$13,730	.9216	$30,511
1982	12,821	11,640	.9079	22,285
1981	14,040	12,728	.9065	21,558
1980	15,026	13,494	.8980	20,089
1979	20,015	18,352	.9169	25,882
1978	21,895	20,491	.9358	29,027
1977	20,849	19,324	.9268	25,730
Seven-Year Inflation-Adjusted Weighted-Average:			.9181	

(1) Current Dollars
(2) Equals Ford Total U.S. Sales times larger of a) same year worldwide auto/worldwide total sales ratio or b) seven-year inflation-adjusted weighted-average worldwide auto to worldwide total ratio (.9181).

NOTE: This methodology might OVERSTATE Ford's U.S. Auto-related sales, as Ford probably has a greater percentage of its non-automotive operations in the U.S. than abroad. This will result in OVERSTATED average revenues per vehicle and taxes paid.

Source: (for sales) Annual Reports

Table 1j. 1983 GM/Ford Weighted-Average Revenues Per Vehicle

	U.S. AUTOMOTIVE RELATED REVENUES	U.S. FACTORY SALES	REVENUES PER SALE
GM	$63,655,000,000	5,119,000	$12,435
FORD	$30,511,400,000	2,665,711	$11,446
TOTAL	$94,166,400,000	7,784,711	$12,096

NOTE: GM Revenues from Annual Report; Ford's from Table 1i;
Used factory sales rather than alternatives (e.g. factory shipments, retail sales, production, etc.) to most closely match with revenues in an accounting sense, i.e. recognition.
Also, per vehicle revenues are OVERSTATED in that a portion of both GM's and Ford's auto-related revenues pertain to the aftermarket, and not OE.

o Additional Factory Sales Information.....Thousand Units:

	GENERAL MOTORS(1)		FORD(1)	
YEAR	Worldwide	U.S.	Worldwide	U.S.
1983	7,769	5,119	4,934	2,666
1982	6,244	4,042	4,268	2,074
1981	6,762	4,611	4,313	2,102
1980	7,101	4,771	4,328	2,151
1979	8,993	6,445	5,810	3,227
1978	9,482	6,878	6,462	4,090
1977	9,068	6,695	6,422	3,971

(1) Car and Truck

Source: Annual Reports

Table 1k. Domestic Wholesale/OE Manufacturing Income Taxes

- Equals:

  (1983 GM/Ford Weighted-Average U.S. Automotive-Related Revenues Per Factory Sale) x (Seven-Year Inflation-Adjusted GM/Ford Weighted-Average Pre-Tax Profit as a Percent of Sales) x (Seven-Year Inflation-Adjusted GM/Ford Weighted-Average Effective Tax Rate) =

  $12,096 x 3.62% x 41.6% = $12,096 x .0362 x .416 = $182.

TABLE 2. DOMESTIC WHOLESALE/OE MANUFACTURING OTHER TAXES*
($ millions)

	GENERAL MOTORS			FORD		
YEAR	OTHER TAXES(1)	FACTORY SALES	TAX PER VEHICLE	OTHER TAXES(1)	FACTORY SALES	TAX PER VEHICLE
1983	$2,676	7,769,000	$344		N/A	
1982	2,470	6,244,000	395		N/A	
1981	2,505	6,762,000	370	$1,209	4,313,188	$280
1980	2,249	7,101,000	316	1,233	4,328,450	285
1979	2,324	8,993,000	258	1,300	5,810,304	223
1978	2,248	9,482,000	237	1,090	6,462,065	168

(1) Includes primarily social security, unemployment compensation and property taxes.

NOTE: Corporate totals only available.
Historically, it can be seen that Ford has contributed fewer taxes per vehicle than GM, perhaps due to differing levels of vertical integration. However, as Ford has discontinued reporting these figures, it is necessary to rely on the GM figure, probably OVERSTATING the amount per vehicle for the average vehicle.
Also, will be OVERSTATED as other taxes include taxes paid on non-automotive operations (approximately 6%-7% of total).

Source: GM/Ford Annual Reports

- Therefore, Domestic Wholesale/OE Manufacturing Other Taxes are estimated to be $344 per vehicle.

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*Not possible to separate distribution from manufacturing via general publicly-available documents.

TABLE 3. DOMESTIC SUPPLIERS: INCOME TAXES

BASIC CALCULATION:

- (1983 GM/Ford Weighted-Average Automotive Revenues Per Vehicle Sold) x (1-Percent Value Added by OE) x (Five-Year Inflation-Adjusted Supplier Weighted-Average Pre-Tax Profit as a Percent of Sales) x (Five-Year Inflation-Adjusted Supplier Weighted-Average Effective Tax Rate)

SUPPORTING TABLES:

- Table 3a. Domestic Suppliers: Dollar Sales
- Table 3b. Domestic Suppliers: Pre-Tax Profit
- Table 3c. Domestic Suppliers: Profitability (Including Five-Year Inflation-Adjusted Weighted Average Pre-Tax Profit to Sales)
- Table 3d. Domestic Suppliers: Income Taxes
- Table 3e. Five-Year Inflation-Adjusted Weighted-Average Effective Tax Rate
- Table 3f. Estimate of Vertical Integration and Note
- Table 3g. Domestic Suppliers: Income Taxes

Table 3a. Domestic Suppliers: Dollar Sales ($ thousands)

NOTE: ALL AMOUNTS ARE IN CONSTANT 1967 DOLLARS (CPI-U)

YEAR	EATON	SHELLER-GLOBE	A.O. SMITH
1983	$896,154	$203,753	$285,983
1982	848,347	173,009	240,122
1981	1,043,163	187,992	287,720
1980	1,287,060	182,546	281,071
1979	1,545,499	264,864	384,744
TOTAL	$5,620,223	$1,012,164	$1,479,640

FIVE-YEAR SUPPLIER TOTAL SALES (CONSTANT $) = $8,112,027

Source: Annual Reports

Table 3b. Domestic Suppliers: Pre-Tax Profit ($ thousands)*

NOTE: ALL AMOUNTS ARE IN CONSTANT 1967 DOLLARS

YEAR	EATON	SHELLER-GLOBE	A.O.SMITH
1983	$49,075	$9,316	$6,182
1982	20,192	8,100	(8,830)
1981	78,562	11,340	(5)
1980	71,585	669	(7,486)
1979	135,606	12,526	20,199
TOTAL	$355,020	$41,951	$10,060

FIVE-YEAR SUPPLIER TOTAL PRE-TAX PROFITS (CONSTANT DOLLAR) = $407,031

*Income before unusual items and income taxes

Source: Annual Reports

Table 3c. Domestic Suppliers: Profitability

PROFIT BEFORE TAX AS A PERCENT OF SALES

YEAR	EATON	SHELLER-GLOBE	A.O. SMITH
1983	5.5%	4.6%	2.2%
1982	2.4	4.7	(3.7)
1981	7.5	6.0	0.0
1980	5.6	0.4	(2.7)
1979	8.8	4.7	5.2
FIVE-YEAR INFLATION ADJUSTED AVERAGE	6.3%	4.1%	0.7%

- Five-Year Inflation-Adjusted Supplier Weighted-Average Pre-Tax Profit as a Percent of Sales equals:

$$\frac{\$407,031}{\$8,112,027} = 5.0\%$$

Table 3d. Domestic Suppliers: Income Taxes ($ thousands)

NOTE: ALL AMOUNTS IN CONSTANT 1967 DOLLARS

YEAR	EATON	SHELLER-GLOBE	A.O. SMITH
1983	$7,661	$3,753	$3,083
1982	(18,026)	3,384	(4,808)
1981	31,692	4,861	110
1980	34,946	(162)	(4,133)
1979	65,107	5,376	8,655
TOTAL	$121,380	$17,212	$2,907

FIVE-YEAR INFLATION-ADJUSTED CONSTANT DOLLAR SUPPLIER
TOTAL INCOME TAXES = $141,499

Source: Annual Reports

Table 3e. Five-Year Inflation-Adjusted Supplier Weighted-Average Effective Tax Rate

(Tax as a Percent of Pre-Tax Profit)

YEAR	EATON	SHELLER-GLOBE	A.O. SMITH
1983	15.6%	40.2%	49.8%
1982	(89.3)	41.7	N/M
1981	40.3	42.8	N/M
1980	48.8	(24.2)	N/M
1979	48.0	42.9	42.8
FIVE-YEAR INFLATION ADJUSTED WEIGHTED-AVERAGE	34.2%	41.0	28.9

- Five-Year Inflation-Adjusted Supplier Weighted-Average Effective Tax Rate equals:

$$\frac{\$141,499}{\$407,031} = 34.7\%$$

N/M: Not Meaningful (pre-tax loss)

Table 3f. Estimate of Vertical Integration and Note

- Domestic suppliers are responsible for a percentage of the total value added of each vehicle equal to 100% less the percent value added by the OE manufacturer (roughly revenues minus purchased materials); this OE percent is also referred to as the "degree of vertical integration." Some of the domestic OEs used to report purchases in their annual reports (see for example GM 1979). Historically, GM has added about 50% of the total value to the vehicle; other domestic OEs a lesser percentage.

- Recent estimates of vertical integration have been hard to substantiate. Our estimate is as follows:

	% OF GM/FORD 1983 VOLUME(1)	DEGREE OF VERTICAL INTEGRATION(2)
General Motors	65.7%	47%
Ford	34.3	37%
WEIGHTED-AVERAGE:		43.6%

(1) U.S. Factory Sales, Car and Truck
(2) Based on 1979 annual reports and other public data sources

- Recent articles have indicated that changes in the supplier/automaker relationship have resulted in lower levels of vertical integration. It is estimated, therefore, that the current GM/Ford weighted-average degree of vertical integration is 40%.

Table 3g. Domestic Suppliers: Income Taxes

- Equals:

  (1983 GM/Ford Weighted-Average Automotive Revenues Per Vehicle Sold) x (1-Degree of Vertical Integration) x (Five-Year Inflation-Adjusted Supplier Weighted-Average Pre-Tax Profit as a Percent of Sales) x (Five-Year Inflation-Adjusted Supplier Weighted-Average Effective Tax Rate) =

  $12,096 x (1-.40) x 5.0% x 34.7% =

  $12,096 x .6 x .05 x .347 = $126

TABLE 4. DOMESTIC SUPPLIERS: OTHER TAXES

NOTE: "Other Taxes" not available from annual reports or 10-Ks. They are, however, for the most part closely related to payroll. Therefore, domestic supplier other taxes have been estimated using payroll and other tax rates as supplied by OE manufacturers.

BASIC CALCULATION:

- Domestic Supplier Other Taxes Per Vehicle = (Number of supplier employees associated with GM/Ford volume) x (average supplier employee compensation) x (other tax contribution rate) divided by GM/Ford factory sales.

SUPPORTING TABLES:

- Table 4a. GM/Ford "Other Taxes" as a Percent of Payroll
- Table 4b. GM/Ford U.S. Employees
- Table 4c. Associated Supplier Employment: GM/Ford Factory Sales
- Table 4d. Average Supplier Employee Compensation
- Table 4e. Domestic Suppliers: Other Taxes

Table 4a. GM/Ford "Other Taxes" As A Percent of Payroll

	GENERAL MOTORS			FORD		
YEAR	OTHER TAXES	PAYROLL	%	OTHER TAXES	PAYROLL	%
1983	$2,675.8(1)	$19,605(1)	13.6%		N/A	
1982	2,470.3	17,043	14.5		N/A	
1981	2,505.5	19,257	13.0	$1,209(1)	$9,380(1)	12.9%
1980	2,248.8	17,799	12.6	1,233	9,519	12.9
1979	2,324.6	18,851	12.3	1,300	10,169	12.8
1978	2,247.9	17,195	13.1	1,090	9,774	11.1
Average:			13.2%			12.4%

(1) Corporate total in millions
Source: Annual Reports

- Estimate for 1983 using historical averages weighted by 1983 production volumes:

	% OF GM/FORD 1983 VOLUME(1)	AVERAGE OTHER "TAX RATE"
General Motors	65.7%	13.2%
Ford	34.3	12.4
WEIGHTED-AVERAGE:		12.9%

- However, since Ford data is not up to date, assumed GM 1983 figure as representative (i.e. 13.6%); appears to OVERSTATE typical "Other Taxes" paid per domestic vehicle.

N/A: Not available from annual reports

Table 4b. GM/Ford U.S. Employees (1983)

GENERAL MOTORS	463,000
FORD	163,356
TOTAL	626,356

NOTE: OVERSTATES automotive-related employment by OE manufacturers (figures include non-automotive employees)

- General Motors U.S. Employees x (U.S. Auto Revenues/ U.S. Total Revenues) = 463,000 x .962 = 445,406
- Ford U.S. Employees x (U.S. Auto Revenues*/U.S. Total Revenues) = 163,356 x .921 = 150,451
- Total GM/Ford Auto-Related Employment = 595,857

Source: Annual Reports

*As calculated in Table 1i.

Table 4c. Associated Supplier Employment: GM/Ford Factory Sales

- According to the U.S. Department of Labor (Direct Supplier Industry Labor Requirements (Jobs per 100 Jobs in SIC Classification 371, Motor Vehicles and Motor Vehicle Equipment), U.S. Department of Labor, Bureau of Labor Statistics, as exhibited in O'Donnell and MacLennan, The Effects of the Automotive Transition on Employment: A Plant and Community Study, U.S. Department of Transportation, December 1980) there are 105 jobs in supplier industries for each 100 in vehicle manufacturing.

- GM/Ford OE Jobs x 1.05 = 595,857 x 1.05 = 625,650

NOTE: This number is OVERSTATED since a portion of the jobs at GM/Ford are in components and not strictly vehicle assembly.

Table 4d. Average Supplier Employee Compensation

- According to the Department of Labor (Employment and Earnings, U.S. Department of Labor, Bureau of Labor Statistics, July 1984; p.121) the average weekly earnings of employees in SIC 3714 (Motor Vehicle Parts and Accessories) in July 1983 was $512.28.

- Estimated annual wages = $512.28 x 52 = $26,638

Table 4e. Domestic Suppliers: Other Taxes

- (Total Payroll x Average "Other Tax Rate")/GM-Ford Factory Sales:

  (625,650 employees x $26,638 x .136)/7,784,711 =

  = $291.

TABLE 5. DOMESTIC WHOLESALE/OE MANUFACTURING EMPLOYEE TAXES

BASIC CALCULATION:

- (Average OE Annual Wage) x (Effective Tax Rate--Income and Social Security--for that level of income) x (Number of GM/Ford auto-related employees) divided by GM/Ford vehicles

SUPPORTING TABLES:

- Table 5a. Domestic Wholesale/OEM Employee Compensation
- Table 5b. Individual Tax Rates
- Table 5c. Domestic Wholesale/OE Manufacturing Employee Taxes

Table 5a. Domestic Wholesale/OEM Employee Compensation

YEAR	FORD U.S. PAYROLL	EMPLOYEES	ANNUAL COMPENSATION
1983	$5,886.3 (1)	163,356	$36,034
1982	5,352.7	155,901	34,334
1981	5,507.5	170,806	32,244
1980	5,248.5	179,917	29,172
1979	6,262.6	239,475	26,151
1978	6,581.2	256,614	25,646
1977	5,653.4	239,303	23,624

Source: Annual Reports

(1) $ millions

NOTE: Corresponding information not supplied by GM

- Compare with 1983 average earnings for employees in SIC 371 (Transportation Equipment) of approximately $27,789 annually (Department of Labor)

Table 5b. Individual Tax Rates

NOTE: BASED ON ANNUAL INCOME OF $36,034

TAX:	FEDERAL INCOME	STATE INCOME	SOCIAL SECURITY
RATE			
Statutory	-	6.35% (1)	6.70% (2)
Effective	15.2% (3)	5.29 (4)	6.63% (5)

TOTAL EFFECTIVE TAXE RATE: 27.1%

(1) State of Michigan flat rate individual income tax (from Statistical Abstracts 1984)

(2) U.S. Social Security Administration

(3) Effective Federal income tax rate for married couple filing jointly with two dependents with gross income of $36,000

(4) Assuming deductions for spouse and children (2)

(5) Maximum payment of $2,392 for 1983

Source: Statistical Abstract of the United States 1984

Table 5c. Domestic Wholesale/OE Manufacturing Employee Taxes

- Annual Wage times Effective Tax Rate x Number of Employees divided by Number of Vehicles:

($36,034 x .271 x 595,857)/7,784,711 = $747

TABLE 6. DOMESTIC SUPPLIER EMPLOYEE TAXES

BASIC CALCULATION:

- (Average Supplier Employee Wage) x (Effective Tax Rate) x (Number of Employees)/Units

SUPPORTING TABLES:

- Table 6a. Individual Tax Rates
- Table 6b. Domestic Supplier Employee Taxes

Table 6a. Individual Tax Rates

NOTE: BASED ON ANNUAL INCOME OF $26,638*

	FEDERAL INCOME	STATE INCOME	SOCIAL SECURITY
STATUTORY	-	6.35%	6.70%
EFFECTIVE	11.3%	4.91	6.70

TOTAL EFFECTIVE TAX RATE: 22.9%

*See Table 5b for explanations and sources.

Table 6b. Domestic Supplier Employee Taxes

- (Annual Wage) x (Effective Tax Rate) x (Number of Employees)/Units:

  ($26,638 x .229 x 625,650)/7,784,711 = $490

TABLE 7. IMPORT WHOLESALE DISTRIBUTION INCOME AND OTHER TAXES (1983)

- Japanese Import Car and Truck Sales: 1983

	TOYOTA	NISSAN	HONDA	MAZDA	TOTAL(1)
CAR	555,766	521,902	350,670	173,388	1,812,052
TRUCK	171,052	125,640	-	76,150	408,370
TOTAL	726,818	647,542	350,670	249,538	2,220,422

(1) Does not include captive imports

- Total Taxes Paid/Import Volume =

  = $333.6 million (2) / 2,220,422 = $150

(2) Based on data provided by importers.

TABLE 8. IMPORT WHOLESALE DISTRIBUTION: DUTIES PAID (1983)

- Total Duties Paid (1)(2) / Import Volume =

  $733.65 million/2,220,422 = $330

(1) Does not include parts duties
(2) Based on information supplied by importers

TABLE 9. JAPANESE OE MANUFACTURERS: INCOME TAXES

BASIC CALCULATION:

- (1983 Toyota/Nissan Weighted-Average Automotive-Related Revenues Per Vehicle) x (Five-Year Inflation-Adjusted Toyota/Nissan Weighted-Average Pre-Tax Profit as a Percent of Sales) x (Five-Year Inflation-Adjusted Toyota/Nissan Weighted-Average Effective Income Tax Rate)

SUPPORTING TABLES:

- Table 9a. Japanese OE Manufacturers: Yen Sales
- Table 9b. Japanese Inflation Index
- Table 9c. Nissan: Automotive-Related Sales
- Table 9d. Japanese OE Manufacturers: Pre-Tax Income
- Table 9e. Japanese OE Manufacturers: Profitability
- Table 9f. Japanese OE Manufacturers: Income Taxes
- Table 9g. Japanese OE Manufacturers: Effective Tax Rates
- Table 9h. 1983 Weighted-Average Automotive-Related Revenues Per Vehicle
- Table 9i. Japanese OE Manufacturers: Income Taxes

Table 9a. Japanese OE Manufacturers: Yen Sales (millions)

	TOYOTA		NISSAN	
YEAR	CURRENT	CONSTANT(1)	CURRENT	CONSTANT(1)
1983	¥4,892,663	¥1,568,161	¥3,187,722	¥1,021,705
1982	3,849,544	1,267,131	3,198,724	1,052,904
1981	3,506,412	1,188,614	3,016,190	1,022,437
1980	3,310,181	1,179,679	2,738,868	976,075
1979	2,802,469	1,078,702	2,306,685	887,990
TOTAL	¥18,361,269	¥6,282,287	¥14,448,189	¥4,960,990

FIVE-YEAR INFLATION ADJUSTED TOYOTA/NISSAN TOTAL SALES:

¥11,243,277

(1) Consumer Price Index (1967=100) analogous to the U.S. CPI-U (See Table 9b)

NOTE: SALES FIGURES ARE CORPORATE TOTALS

Source: Annual Reports, Japan Company Handbook

Table 9b. Japanese Inflation Index

YEAR	1967 = 100	100/INDEX
1983	312.0	.3205128
1982	303.8	.3291639
1981	295.0	.338983
1980	280.6	.356379
1979	259.8	.3849114

Source: Statistical Abstracts 1984 (1983 figure from 1982 adjusted for 1982-1983 inflation rate)

Table 9c. Nissan: Automotive-Related Sales

YEAR	TOTAL (¥ billion)	AUTO	% AUTO/TOTAL
1983	¥3,187	¥3,141	98.5%
1982	3,198	3,148	98.4
1981	3,016	2,961	98.2
1980	2,738	2,685	98.1
1979	2,306	2,266	98.3

Source: Annual Reports

Table 9d. Japanese OE Manufacturers: Pre-Tax Income

(¥ million)

	TOYOTA		NISSAN	
YEAR	CURRENT	CONSTANT	CURRENT	CONSTANT
1983	¥398,591	¥127,753	¥165,377	¥ 53,005
1982	298,489	98,252	191,768	63,123
1981	231,227	73,382	177,011	60,004
1980	288,668	102,875	204,657	72,935
1979	200,658	77,236	136,665	52,604
TOTAL	¥1,417,633	¥479,498	¥875,478	¥301,671

FIVE-YEAR INFLATION-ADJUSTED TOYOTA/NISSAN TOTAL PRE-TAX PROFIT:

¥781,169

Source: Annual Reports, Japan Company Handbook

Table 9e. Japanese OE Manufacturers: Profitability

PRE-TAX PROFIT AS A PERCENT OF SALES

	TOYOTA		NISSAN	
YEAR	Current	Constant	Current	Constant
1983	8.1%	8.1%	5.2%	5.2%
1982	7.7	7.7	6.0	6.0
1981	6.6	6.6	5.9	5.9
1980	8.7	8.7	7.5	7.5
1979	7.2	7.2	6.0	6.0
AVERAGE	7.7%	7.7%	6.1%	6.1%
WEIGHTED-AVERAGE	7.7	7.6	6.0	6.1

TOYOTA/NISSAN:	Current	Constant
AVERAGE	6.9%	6.9%
WEIGHTED-AVERAGE	7.0	6.95

- FIVE-YEAR TOYOTA/NISSAN INFLATION-ADJUSTED WEIGHTED-AVERAGE PRE-TAX PROFIT AS A PERCENT OF SALES:

$$\frac{¥781,169}{¥11,243,277} = 6.95\%$$

Table 9f. Japanese OE Manufacturers: Income Taxes

(¥ millions)

	TOYOTA		NISSAN	
YEAR	CURRENT	CONSTANT	CURRENT	CONSTANT
1983	¥197,219	¥ 63,211	¥ 69,900	¥ 22,404
1982	156,900	51,646	105,700	34,793
1981	98,500	33,390	91,100	30,881
1980	145,100	51,711	117,200	41,677
1979	98,600	37,952	71,200	27,406
TOTAL	¥696,319	¥237,910	¥455,100	¥157,161

FIVE-YEAR INFLATION-ADJUSTED TOYOTA/NISSAN TOTAL INCOME TAXES:

¥395,071

Source: Annual Reports, Japan Company Handbook

Table 9g. Japanese OE Manufacturers: Effective Tax Rates

INCOME TAXES AS A PERCENT OF PRE-TAX PROFITS

	TOYOTA		NISSAN	
YEAR	CURRENT	CONSTANT	CURRENT	CONSTANT
1983	49.5%	49.5%	42.3%	42.3%
1982	52.3	52.3	55.1	55.1
1981	42.6	42.6	51.5	51.5
1980	50.3	50.3	57.3	57.3
1979	49.1	49.1	52.1	52.1
AVERAGE	48.8%	48.8%	51.7%	51.7%
WEIGHTED-AVERAGE	49.1	49.6	52.0	52.1

TOYOTA/NISSAN:	CURRENT	CONSTANT
AVERAGE	50.2%	50.2%
WEIGHTED-AVERAGE	50.2	50.6

- FIVE-YEAR INFLATION-ADJUSTED TOYOTA/NISSAN WEIGHTED-AVERAGE EFFECTIVE TAX RATE ON INCOME:

$$\frac{¥395,071}{¥781,169} = 50.6\%$$

Table 9h. 1983 Weighted-Average Automotive-Related Revenues Per Vehicle

(¥ millions)

	¥ SALES	UNIT SALES(1)	REVENUES/VEHICLE
TOYOTA	¥4,892,663	3,411,335	¥1.434237
NISSAN	3,141,357(2)	2,674,173	1.174702
TOTAL/ AVERAGE	¥8,034,020	6,085,508	¥1.320189

(1) Includes KD sets
(2) Toyota is corporate total (non-automotive is very small percentage --housing--and not broken out); Nissan is automotive only (See Table 9c).

- Therefore, the 1983 Toyota/Nissan weighted-average automotive revenues per vehicle is ¥1,320,189
- Using an exchange rate of $1 = ¥240 (the rate used in the Japanese OEM 1983 Annual Reports; approximate rate on March 31, 1983), this becomes:

$5,501

- NOTE: This is a conservative exchange rate. That is, for example at ¥210 = $1, this figure becomes $6,287

Table 9i. Japanese OE Manufacturers: Incomes Taxes

- (Average Revenues Per Vehicle) x (Five-Year Inflation-Adjusted Toyota/Nissan Weighted-Average Pre-Tax Profit as a Percent of Sales) x (Five-Year Inflation-Adjusted Toyota/Nissan Weighted-Average Toyota/Nissan Effective Tax Rate) =

- $5,501 x 6.95% x 50.6% =
- $5,501 x .0695 x .506 = $193

TABLE 10. JAPANESE OE MANUFACTURERS: OTHER TAXES

BASIC CALCULATION:

- Other taxes paid by Japanese corporations include

  --payroll tax for social security programs
  --business premises tax
  --gross compensation tax
  --municipal fixed assets tax

- As the business premises tax and the fixed assets tax require information concerning square footage, etc. of all buildings, this estimate is confined to those taxes sensitive to payroll, i.e. social security and gross compensation. The estimate for Japanese OEM "Other Taxes", therefore, is UNDERSTATED

SUPPORTING TABLES:

- Table 10a. Japanese OE Manufacturers: Employment
- Table 10b. Japanese OEM Employee Compensation
- Table 10c. Japanese OEM Other Tax Rates
- Table 10d. Japanese OE Manufacturers: Other Taxes

Table 10a. Japanese OE Manufacturers: Employment (1983)

TOYOTA	57,846
NISSAN	58,104*
TOTAL	115,950

Source: Annual Reports; Japan Company Handbook.

*Nissan figure calculated as follows: Corporate total of 58,962 employees times ratio of automotive-related/total sales for 1983 (¥3,141,357/¥3,187,722).

Table 10b. Japanese OEM Employee Compensation

- Many estimates have been made of hourly compensation rates in the Japanese auto industry. Total numbers, including salaried personnel, have not been as well covered.

- According to Nissan Motor Co., Ltd., Enterprises of Japan Series #11, H. Kato and K. Noda, eds., Soyosha, Tokyo 1980, in 1978 Nissan's total expenditures for wages and salaries was ¥3,859,165 per employee.

- Since that time, compensation per hour (Japanese national currency basis) has risen at an average of 7.1% annually (from 1975-1980) and 5.1% annually (from 1980). (Source: Statistical Abstracts of the United States)

- Using these rates, Nissan's estimated compensation per total employee would be ¥5,139,529 (or $21,412 at an exchange rate of ¥240 = $1.00; cf. GM/Ford total average of slightly over $36,000).

- A similar calculation for Toyota yields $27,717; this figure, however, includes retirement benefits as well.

- Therefore, the estimate for Japanese OEM Employee Compensation will be based on the lower Nissan figure to be conservative, although this methodology might result in the figure being UNDERSTATED

JAPANESE OEM EMPLOYEE COMPENSATION: $21,412

Table 10c. Japanese OEM Other Tax Rates

NOTE: As percent of payroll

EMPLOYER PAYROLL TAX RATE FOR SOCIAL SECURITY PROGRAMS:	12.80%
GROSS COMPENSATION TAX:	0.25%
TOTAL	13.25%

Source: Social Security: Statistical Abstract of the United States 1984

Gross Compensation: Doing Business in Japan Price Waterhouse, 1983.

Table 10d. Japanese OE Manufacturers: Other Taxes

- (Average Compensation Per Employee) x (Number of Employees) x (Other Tax Rate)/Total Vehicles =

- ($21,412 x 115,950 x .1325)/6,085,508 =

- $54

TABLE 11. JAPANESE SUPPLIERS: INCOME TAXES

BASIC CALCULATION:

- (1983 Toyota/Nissan Weighted-Average Automotive Revenues Per Vehicle) x (1-Degree of OEM Vertical Integration) x (Five-Year Inflation-Adjusted Supplier Weighted-Average Pre-Tax Profits as a Percent of Sales) x (Five-Year Inflation-Adjusted Supplier Weighted-Average Effective Tax Rate)

SUPPORTING TABLES:

- Table 11a. Japanese Suppliers: Yen Sales
- Table 11b. Japanese Suppliers: Pre-Tax Profit
- Table 11c. Japanese Suppliers: Profitability
- Table 11d. Japanese Suppliers: Income Taxes
- Table 11e. Japanese Suppliers: Effective Tax Rate
- Table 11f. Estimate of Vertical Integration
- Table 11g. Japanese Suppliers: Income Taxes

Table 11a. Japanese Suppliers: Yen Sales (¥ millions; 1967 = 100)

NOTE: ALL AMOUNTS IN CONSTANT YEN

YEAR	NIPPONDENSO	TOKICO	AISIN SEIKI
1983	¥ 211,538	¥ 22,303	¥ 81,031
1982	200,094	23,470	81,593
1981	196,326	24,420	77,934
1980	184,376	21,016	72,043
1979	174,963	19,366	67,414
TOTAL	¥ 967,297	¥ 110,575	¥380,015

- FIVE-YEAR INFLATION-ADJUSTED SUPPLIER TOTAL SALES:

¥ 1,457,887

Source: Japan Company Handbook

Table 11b. Japanese Suppliers: Pre-Tax Profit

NOTE: ALL AMOUNTS ARE IN CONSTANT 1967 ¥ MILLIONS

YEAR	NIPPONDENSO	TOKICO	AISIN SEIKI
1983	¥ 19,872	¥ 725	¥ 4,611
1982	18,312	1,126	4,823
1981	17,557	1,318	4,919
1980	17,349	1,252	5,215
1979	20,261	969	4,572
TOTAL	¥ 93,351	¥5,390	¥21,140

- FIVE-YEAR INFLATION-ADJUSTED SUPPLIER TOTAL PRE-TAX PROFIT:

¥ 122,881

Source: Japan Company Handbook

Table 11c. Japanese Suppliers: Profitability

PRE-TAX PROFIT AS A PERCENT OF SALES

NOTE: ALL AMOUNTS ARE IN CONSTANT 1967 ¥ MILLIONS

YEAR	NIPPONDENSO	TOKICO	AISIN SEIKI
1983	9.4%	3.3%	5.7%
1982	9.1	4.8	5.9
1981	8.9	5.4	6.3
1980	9.4	5.9	7.2
1979	11.6	5.0	6.8
WEIGHTED-AVERAGE	9.65%	4.87%	6.35%

- FIVE-YEAR INFLATION-ADJUSTED SUPPLIER WEIGHTED-AVERAGE PRE-TAX PROFIT AS A PERCENT OF SALES:

$$\frac{¥\ 122,881}{¥1,457,887} = 8.43\%$$

Table 11d. Japanese Suppliers: Income Taxes

NOTE: ALL AMOUNTS ARE IN CONSTANT 1967 MILLION YEN

YEAR	NIPPONDENSO	TOKICO	AISIN SEIKI
1983	¥ 9,936	¥ 312	¥ 2,280
1982	9,645	545	2,354
1981	9,136	674	2,430
1980	8,582	664	2,524
1979	10,246	487	2,207
TOTAL	¥ 47,545	¥ 2,679	¥ 11,795

- FIVE-YEAR INFLATION ADJUESTED SUPPLIER TOTAL INCOME TAXES:

¥ 62,019

Source: Japan Company Handbook

Table 11e. Japanese Suppliers: Effective Tax Rates

INCOME TAXES AS A PERCENT OF PRE-TAX PROFITS

NOTE: ALL AMOUNTS ARE IN CONSTANT 1967 MILLION YEN

YEAR	NIPPONDENSO	TOKICO	AISIN SEIKI
1983	50.0%	43.0%	49.4%
1982	52.7	48.4	48.8
1981	52.0	51.1	49.4
1980	49.5	53.0	48.4
1979	50.6	50.3	48.3
WEIGHTED-AVERAGE:	50.9%	49.7%	48.9%

- FIVE-YEAR INFLATION-ADJUSTED SUPPLIER WEIGHTED-AVERAGE INCOME TAXES AS A PERCENT OF PRE-TAX PROFIT:

$$\frac{¥\ 62,019}{¥122,881} = 50.5\%$$

Table 11f. Estimate of Vertical Integration

- See Table 3f for general note

- According to the OECD (Industrial Structure Statistics; Paris 1984) value added as a percent of sales for the Japanese motor vehicle industry (Industrial Classification 3843) in 1981 (the most recent figures presented) was:

$$\frac{¥5,842,000,000,000}{¥21,336,000,000,000} = 27.4\%$$

- Therefore, the suppliers account for the remaining 72.6%

Table 11g. Japanese Suppliers: Income Taxes Per Vehicle

- (Weighted-Average 1983 Toyota/Nissan Automotive Revenues Per Vehicle) x (1-Degree of Vertical Integration) x (Five-Year Inflation-Adjusted Supplier Weighted-Average Pre-Tax Profit as a Percent of Sales) x (Five-Year Inflation-Adjusted Supplier Weighted-Average Income Taxes as a Percent of Pre-Tax Profit) =

- $5,501 x .726 x .0843 x .505 = $170

TABLE 12. JAPANESE SUPPLIERS: OTHER TAXES

- See Table 10 for note on "Other Taxes" in Japan

SUPPORTING TABLES:

- Table 12a. Japanese Supplier Employment Associated with Toyota/Nissan volume
- Table 12b. Japanese Supplier Employee Compensation
- Table 12c. Japanese Suppliers: Other Taxes

Table 12a. Japanese Supplier Employment Associated with Toyota/Nissan Volume

- According to The Structure of the Japanese Auto Parts Industry (Dodwell Marketing Consultants, Tokyo 1983) employment in the Japanese auto industry is as follows:

Automobile Industry	187,035
Automobile Parts Industry	466,643
Automobile Body Industry	50,638
TOTAL	704,316

- Therefore, there are 517,281 supplier jobs for 187,035 automobile jobs, or 2.76 supplier jobs per auto job.

- Toyota/Nissan auto-related employment of 115,950 x 2.76 = 320,022

NOTE: Compare 187,035 jobs/704,316 jobs (26.5%) as another measure of degree of vertical integration (cf. 27.4% in Table 11f). However, the 27.4% estimate has been used as it is more conservative (i.e. results in an UNDERSTATED amount of income taxes paid by suppliers).

Table 12b. Japanese Suppliers Employee Compensation

- According to the OECD (Industrial Structure Statistics, Paris 1984) average compensation (wages and salaries) in the Japanese motor vehicle industry was ¥3,181,818 in 1980 (the most recent year presented).

- Applying the average annual increase in manufacturing wages in Japan for the intervening years (Statistical Abstract; see Table 10b) the 1983 figure is:

¥3,693,886

- At an exchange rate of ¥240 = $1; this becomes

$15,391

Table 12c. Japanese Suppliers: Other Taxes

- (Number of Employees Associated with Toyota/Nissan 1983 Volume) x (Average Annual Wage) x (Effective Other Tax Rate--Table 10c)/Toyota-Nissan 1983 Volume =

- (320,022 x $15,391 x .1325)/6,085,508 =

- $107

TABLE 13. IMPORT DISTRIBUTION: EMPLOYEE TAXES

(BASED ON INFORMATION SUPPLIED BY IMPORTERS)

- Average Compensation: 1983 = $27,583
- Total Employees = 10,771
- Individual Tax Rate:

Effective Federal:	11.3%
Social Security:	6.7
State Income:*	11.0
TOTAL	29.0%

*California

- (Compensation per Employee) x (Employees) x (Tax Rate)/ Volume =
- $27,583 x 10,771 x .29 divided by 2,220,422 (See Table 7) =
- $39

TABLE 14. JAPANESE OE MANUFACTURERS: EMPLOYEE TAXES

BASIC CALCULATION:

- Number of Employees Associated with Toyota/Nissan 1983 Volume times Average Compensation times Effective Tax Rate for that level of Compensation; divided by 1983 Toyota/Nissan volume

SUPPORTING TABLES:

- Table 14a. Individual Tax Rates
- Table 14b. Japanese OE Manufacturers: Employee Taxes

Table 14a. Individual Tax Rates

- Average annual wage for Japanese OEM employee in 1983 =

  ¥ 5,139,529 (See Table 10b)

- Individual taxes in Japan include:

  --national income tax
  --inhabitants tax
  --social security tax

- For an income of ¥ 5,139,529, effective rates are as follows:

National Income:	4.63% (1)
Inhabitants:	2.83% (1)
Social Security:	10.05% (2)
TOTAL:	17.5%

(1) After deductions for employment income, personal (spouse and two children), and insurance premiums
Source: Price Waterhouse Doing Business in Japan
(2) From Statistical Abstracts

Table 14b. Japanese OE Manufacturers: Employee Taxes

- Employees x Wages x Tax Rate / Volume:

  115,950 x $21,412 x .175 / 6,085,508 =

- $71

TABLE 15. JAPANESE SUPPLIERS: EMPLOYEE TAXES

BASIC CALCULATION:

- Number of Employees Associated with 1983 Toyota/Nissan Volume times Average Compensation times Effective Tax Rate for that level of Compensation; divided by Toyota/Nissan volume

SUPPORTING TABLES:

- Table 15a. Individual Tax Rates
- Table 15b. Japanese Suppliers: Employee Taxes

Table 15a. Individual Tax Rates

- Average annual wage for supplier employees:

  ¥3,693,886

- Individual Taxes in Japan (see Table 14a)

- Effective Tax Rates for ¥3,693,886:

NATIONAL INCOME:	2.92%
INHABITANTS:	1.50
SOCIAL SECURITY:	10.05
TOTAL	14.5%

Table 15b. Japanese Supplier Employee Taxes

- Employees x Compensation x Tax Rate / Vehicles:
- 320,022 x $15,391 x .145 / 6,085,508 =
- $117

TABLE 16. ESTIMATED AVERAGE VEHICLE WHOLESALE PRICES

- Because of differences in vertical integration, it might be inappropriate to use average OE manufacturer automotive-related revenues as a basis for comparing tax burdens on a percentage basis
- A better measure would be to estimate the actual wholesale price associated with the vehicle itself

Table 16a. Domestic

- According to the Department of Commerce (Annual Survey of Manufacturers) in 1981 the average value of a vehicle shipped by the motor vehicle industry was $9,353.
- Applying the CPI-U as an indication of price increases in the intervening years, the estimated average wholesale price per vehicle is:

$10,247

Table 16b. Japanese Imports

- According to Toyota Motor Sales (Facts & Figures 1984), 726,818 Toyota vehicles were sold in 1983 through TMS USA at a gross sale level of $5.3 billion
- Therefore, the estimate for the average wholesale price per imported vehicle is:

$ 7,292

Chairman GIBBONS. A great leader in the American automobile manufacturing industry at one time said to me that we just don't know how to make a small car. I really didn't believe him. I thought he was just trying to gild the lilly a little for me. But if those figures are right, he was right.

Mr. MCELWAINE. They are making some awfully good small cars right now, you know. Look at them from a competitive standpoint, and they look like real competition. They have always been dissuaded from concentrating on the small car market because it was so much more profitable to make large cars.

We feel that they have been forced into the small car market on several occasions and from time to time produce very good small cars. They have been only too happy to ignore that market when they didn't have to concentrate on it. And I really think they have ignored it largely for the last several years.

I think the Saturn project, however, is certainly an indication that at least one manufacturer is going to concentrate very heavily on that small car market, and I certainly hope successfully.

Chairman GIBBONS. Mr. Pease?

Mr. PEASE. Thank you, Mr. Chairman. Thank you, Mr. Nield, and Mr. McElwaine.

Mr. Nield, in your testimony I was just reading in the summary, you say the average price of a new car rose from $7,591 in 1980 to $11,254 in 1984, a 48-percent increase compared to a 27-percent increase in the consumer price index. The result was a $1,600 per vehicle price increase.

What part of that increase would have been due to a change of—or could have been due to a change in product mix? I presume in 1980 people were pretty sensitive to gasoline prices and may have been buying smaller cars more so than buying bigger cars as they have recently.

In order for these figures to be very relevant, it seems to me we have to take into account differences in the product mix. Do you have any information in that regard?

Mr. NIELD. As I indicated in my statement, there is a factor of the product mix change. It is very, very difficult, however, to determine what is the cause of the product mix change and the benefit of that change.

The imposition of quotas has resulted in a noncompetitive marketplace, so if a person wants to buy a car he, in many cases, has to buy what is available. He doesn't have a full choice. He can't decide whether or not he wants a sunroof on the car. The car has got a sunroof which is an option, but it is just not available without it. So he buys a sunroof even if he doesn't want a sunroof. He pays the $500 extra cost for that sunroof. I don't know how to determine just what the cost of the car would have been had the consumers had a choice in what sizes and options they would like to have. But the points you raise are legitimate points. The cars that are sold at that $1,600 additional price are somewhat more luxurious and larger. But it is not at all clear that it was my choice that that more expensive car was selected.

Mr. PEASE. OK, I appreciate your frankness. I don't know what the complete picture is either, but I always get a little nervous when I see what appears to be a simple comparison of sales in one

year and sales in another year, and the conclusion that it costs consumers more. It is quite possible, indeed likely, that consumers also got more for their money in that 4 years.

I guess the question I am interested in is whether you feel the U.S. manufacturers—Chrysler, Ford, General Motors, American Motors—are capable of producing a small car and selling it competitively in the U.S. market.

Mr. McELWAINE. If I may, Mr. Pease, I think they are extremely capable of producing a competitive small car. The fact that domestically produced small cars outsell Japanese small cars by a 60/40 ratio is, I think, indicative of the fact that they can produce and compete in the small car market.

Mr. PEASE. How do you define small car?

Mr. McELWAINE. That is a compact and subcompact as determined by the NHTSA and EPA guidelines.

Mr. PEASE. What about subcompact cars? Are American manufacturers capable of producing a subcompact car and selling it competitively and making a profit?

Mr. McELWAINE. I would think they are. They have produced subcompacts and they have sold—well, they have had good success in many cases.

Mr. PEASE. Have they made money at it?

Mr. McELWAINE. That I can't tell. They claim they don't make money with small cars. Obviously, the profit margin at the low end of the market is much smaller than it is at the high end for everybody, Japanese as well as American manufacturers. Therefore, there is a reluctance to engage in that market.

There is always a feeling on the part of the American manufacturers that small cars sales tend to rob them of sales of the higher profit lines. And they have never been too anxious, but I think they are certainly capable of it. American manufacturers produce small cars in other countries and produce them profitably. In Europe they produce them quite profitably.

Ford is, after all, the largest company operating in Europe.

I don't think there is any question but what they can produce small cars successfully, as long as they feel the competitive need to.

Mr. PEASE. The conventional wisdom is that if the VRA's are lifted, as it appears they will be, that Ford and Chrysler will simply withdraw from the manufacture of at least subcompact cars and satisfy their entire need from imported cars with Ford and Chrysler nameplates on them. Do you think that will happen?

Mr. McELWAINE. I have tried to answer that in my testimony, Mr. Pease, saying no, I don't think that will happen at all. The chairman of the Chrysler Corp. said that he was going to import 200,000 more Mitsubishis immediately, now that the restraints were lifted. However, as I pointed out, Chrysler dealers in January had a 71-day supply of Mitsubishi cars. They seem to be having great difficulty selling 87,000 a year of them. I wonder how they are going to manage to sell 300,000 if they can't handle 87,000 at the present time.

Ford is well underway on its plans to build new small cars in Mexico. That plant has been underway for some time now. They expect the factory now to be built in Flat Rock, Mich., by their Japanese affiliate, Mazda, and it is expected that Ford will get 100,000

to 200,000 cars from that factory in Michigan. I think they are going to have plenty of suppliers for their small cars, without having to go to Japan for more.

Mr. PEASE. Well, the fact Ford will produce in Mexico does not give me and the auto workers of my district a whole lot of comfort. Is it possible for Ford to produce a subcompact in the United States and sell it at a profit?

Mr. MCELWAINE. I would think—well, when the Mazda factory in Michigan goes into operation, that is a Ford operation. Ford is the largest single shareholder in Mazda. They own 25 percent of the company, and this is essentially a joint venture for them, and it will be produced in the United States. They are going to rely on Japanese technology, and on a new labor contract permitting a little more flexibility of work rules, to see if they can produce small cars successfully in this country. I think it will work.

Mr. NIELD. Congressman Pease, it is always sad for me to hear an American industry leader talking of tossing in the towel and moving his production overseas unless he gets protection from import competition. At the same time, the foreign companies are making economic studies and determining that there is a viable opportunity in this country to build automotive products. There are a number of examples, including Honda, of course, and Nissan, but also Volkswagen, Mercedes, Volvo, Saab, Renault—all of these companies have made significant investments in automotive production in the United States successfully.

Mr. PEASE. How many of those are producing subcompacts?

Mr. NIELD. I think quite apart from the subcompact issue, they are automotive products produced with automotive assembly workers, with a wage structure and American way of doing business.

There are differences, of course, between a bus, a truck, and a subcompact car, but there still are management processes and relationships with workers and other things that bring about great improvements in productivity that can be applied for subcompact cars as well as these other types of vehicles.

Mr. MCELWAINE. Mr. Pease, the Nissan that will be produced in Smyrna, TN, the Toyota that will be produced in California and will be on the market this year through G.M. dealers, the Honda in Marysville, OH——

Mr. PEASE. They are all subcompacts?

Mr. MCELWAINE. They are subcompacts.

Mr. PEASE. It is clear to me that the American companies are making plans for building medium size and larger cars. It is just that they claim they can't do the subcompacts. What part of the current price advantage that any foreign cars has over American cars is due to the exchange rate and the strong dollar.

Mr. MCELWAINE. According to Martin Anderson in a Massachusetts Institute of Technology study on this, not more than $200 or $300.

Mr. PEASE. Not more than $200 or $300?

Mr. MCELWAINE. Yes.

Mr. PEASE. That certainly sounds interesting.

Mr. NIELD. There is one thing you have to consider when you talk about the exchange rate of currency. A great deal of the import cost going into a car is paid for in dollars. The oil, for in-

stance, that is imported into Japan, is paid for in dollars, so a high-priced dollar doesn't save them as much as you would think.

Mr. MCELWAINE. Mr. Anderson's conclusion was based on his finding that only a small part of the total cost of Japanese cars is actually yen related, that the vast majority of the cost of the automobile, as it is sold in the United States, is in other currencies, and most of it in the dollar, including energy cost, transportation cost, distribution cost to the United States, advertising cost, dealer profits, distributor profits, all the rest.

Mr. PEASE. Mr. Chairman, I think it certainly would be worthwhile for us to try to get hold of that.

Chairman GIBBONS. We apparently do not have the Anderson report in our staff files. I don't know what classification Mr. Anderson puts on it, or whether it is available, but we would like to have a copy of it.

Mr. MCELWAINE. I probably have a copy of it somewhere in this mess, Mr. Chairman, if I can find it.

Chairman GIBBONS. If you can give it to us, it might save the Government some money. We need everything we can get right now.

Mr. MCELWAINE. I will see to that.

Chairman GIBBONS. I will be happy to read it. We know of Mr. Anderson's reputation. We are apparently not on his mailing list, but we appreciate that.

Mr. PEASE. Mr. Chairman, I will yield back my time.

Chairman GIBBONS. How about Mr. Frenzel over here; does he have anything on his mind?

Mr. FRENZEL. Maybe I can use some that Mr. Pease left me. Mr. Chairman, I am grateful for the witnesses' providing us this testimony today. I think that they have spread additional good information on the record that had been insufficiently displayed, at least up until now. One of the questions that Mr. Crane and I had talked about to previous witnesses—and he reminds me we have not worked on today—is the question of the fuel economy standards.

We asked witnesses from the automobile companies whether those standards should now be repealed, deferred, or whatever, since our problems seem to be something different than an energy shortage at the moment. Two of the manufacturers, Ford and G.M., indicated that that was a peachy idea. The other one, Chrysler, didn't think very highly of it. Do you have an opinion on this, and it is important in our overall considerations?

Mr. NIELD. It certainly does have an effect on this trade issue. The CAFE numbers were established 10 years ago when the knowledge of what would happen at this point in time was rather vague as far as what would fuel cost in 1985, and how stable the supply would be and so forth.

The purpose of the CAFE was to cause manufacturers to improve the efficiency of the automobiles that they would be building as time passed, to the point where we would be less dependent upon imported fuel, and that efficiency has been improved tremendously.

However, we have now gotten to the point where the gains to be made in more efficient designs have just about been reached. If you want to get more miles per gallon, you have to go to smaller cars,

and cars that therefore don't meet the needs for large families, carrying large baggage amounts, and so forth.

So if the requirement is not adjusted at least slightly, there will be a shift—not by choice but by demand—to smaller cars. This then will have an impact, I think, on the trade issue. The domestic industry does better with the larger cars, and the imports seem to have been doing better with the smaller ones.

Mr. FRENZEL. Thank you.

Mr. McElwaine, do you have a comment on this?

Mr. MCELWAINE. I can't resist pointing out that manufacturers appearing before one committee are saying that the CAFE requirements should be lifted because the market has switched to larger, more luxurious automobiles, and they are unable to sell enough small cars to meet the CAFE requirement, and then they come before another committee and say if the restraints on Japanese cars are lifted the Japanese are going to sell 4 million small cars in the United States. There seems to be a contradiction between the two statements there.

Mr. FRENZEL. It is funny, you and Mr. Crane have the same sort of mental process.

Mr. MCELWAINE. The other point, though, on the CAFE standard is that the CAFE requirement does not take into consideration the so-called captive imports. A manufacturer cannot meet the requirements of the corporate average fuel economy standard by bringing in enough imports that are fuel efficient to meet it, and I would think ending the CAFE requirement would simply encourage the manufacturers who have such designs to increase their sourcing of small cars from abroad.

It seems to me that there is a discipline involved in requiring that they meet the corporate average fuel economy with their domestically produced cars that shouldn't be overlooked by the Congress.

Mr. FRENZEL. To me, I guess part of the problem is that absent a national emergency, does the Federal Government have a good role in telling people how to build their cars, other than for reasons of health and safety?

Mr. CRANE. If you will yield on that point.

Mr. FRENZEL. I will be glad to have you answer my question because I think you know the right answer.

Mr. CRANE. The question on my mind is, Where was Ralph Nader when we needed him? You know all of Ralph Nader's concern about safety, the fact of the matter is—and I was just mentioning it to the chairman; I was a traveling salesman back in the midfifties, had a Buick Century, and I guarantee you I would not want to get out on the road and put 80,000 miles on, as I did in one 18-month period running around in a sardine can.

Now I could care less about fuel efficiency. I am concerned about comfort and safety, and the fact of the matter is back in those days, of course, Detroit pooh-poohed the influx of those ugly little beetles and said that will never constitute a market in the United States. But then when Congress put burdens on them, on this fuel economy question, they are getting into a market that was alien. I think they still resent being in that market, being forced into that market.

They would much prefer to get out of it, and that is why Congressman Frenzel and I concluded why don't we just jerk those outmoded fuel economy standards, which were all predicated on false premises anyway, and let Detroit be Detroit, and satisfy, then, the second- and third-car market in the family today which can afford it, with very economically priced, fuel efficient and intensely well-made foreign imports. I think Detroit would breathe a sigh of relief, too, and we would all be better off.

I thank you for yielding.

Mr. FRENZEL. I thank you for your contribution, but I do want to make the record crystal clear that it was not I who asked where Ralph Nader was.

Chairman GIBBONS. Where is he anyway?

Mr. FRENZEL. I would like to ask both of the witnesses this. It has been stated here that while margins for Japanese producers are lower than for American producers, obviously they are a major beneficiary in terms of price-per-automobile increase of the quota system. We have a number of witnesses, a number of editorialists, commenting on who gets the best deal out of the voluntary restraint agreement.

As far as the people from whom you import automobiles, are they wanting to keep the restaints on? Are they liking the high margins, or do they have another opinion?

Mr. NIELD. Congressman Frenzel, as I stated in my testimony, our organization, which represents the 18 significant manufacturers imported into this country—including European manufacturers—have unanimously urged that the retraints be ended.

It almost sounds strange to have reached that unanimous agreement among our members, because you might think that the Europeans really are not involved in the issue at all. There is not a European restraint, and perhaps they could sell more cars if the Japanese cars are restrained. Perhaps that thought did cross their minds. But it seems to me that the European and the Japanese companies see things in a longer term view than Americans. They don't think in terms of the next 10-day sales period, profits for this year, this year's executive bonuses, and this sort of thing. They think in terms of where they will be 10 years from now.

In our discussions it was very clear that they felt that the restraints, whatever benefits they might have in the short run, would have very bad effects on their long-term future. It would establish itself as a permanent type of restraint to doing business. Other decisions would be made on the basis of these restraints. They would not be healthy decisions, but they would be expedient decisions based on the existence of the restraints. And so they all agreed that the most healthy thing for the industry as a whole would be to have these artificial restraints dropped.

Mr. FRENZEL. I can't imagine anyone whose markets were substantially external wanting to support any kind of restraint of this kind. It seems to me to be totally opposed to their long-term best interests.

Mr. McElwaine, did you have a comment?

Mr. MCELWAINE. I can substantiate Mr. Nield's statement. We were in Japan all last week. We met with executives of all the Japanese production companies, including the largest, and they were

unanimous in their statements to us that they felt there was an opportunity now to end the quotas on their exports to the United States, and that this might well be the last time such an opportunity existed. That if they were not ended now, they assumed there would be permanent protection in the United States and there would always be quotas. I think that mirrors their attitude.

Mr. FRENZEL. It mirrors mine too. Normally, when a country puts on some sort of a restriction, protectionist crutch, the only way to get it off is to have the whole situation deteriorate to where we have a depression, and then we decide we will pass the reciprocal trade act and make everything right again. I doubt that we can afford that, and I doubt that anybody would want it.

I yield to my friend.

Mr. CRANE. I thank you for yielding.

You gentleman have brought something up that is also a matter of concern to the committee, looking down the road with alterations in our tax code, and what the Japanese said to you they have said to us about the long-term planning and the essentiality of that, to think in the long term. And our system in this country, unfortunately, tends to punish the CEO who wants to make long-term plans, because the stockholders are looking for the short-term return, and we have contemplated, in revisions of the Tax Code, that Treasury has at least surfaced with treating capital gains as regular income.

Now, one beneficial thing that they have proposed is the elimination of the double taxation of dividends, but if you do that and you simultaneously eliminate the preference in the Code for people to invest, put venture capital forward for long-term growth and expansion, doesn't that tend to reinforce the very deficiency the Japanese identified with our corporate structure right now, make it even worse potentially in the long term?

Mr. MCELWAINE. I couldn't agree with you more, Mr. Crane. The emphasis on short-term profit I think has been the single most devastating influence on the American automobile industry, the necessity for the chief executives to pay large dividends and show large profit has worked against capital investment.

Mr. Crandall's statement, from the Brookings Institute, showed that the rate of increase in new plants and equipment being spent in the United States by the domestic auto manufacturers has declined since the quotas went into effect, and that is unfortunate.

I trace that directly to the terrible pressure on American executives to show a profit, pay dividends, plus the incentives that are built into his retirement pay and his own wages to show such profits.

Mr. FRENZEL. Thank you.

Speaking of Mr. Crandall, we have had a\wide range of estimates as to what the restraint agreement cost the consumers of the United States. Are you satisfied with the ITC's appraisal or do you support some other numbers?

Mr. MCELWAINE. I have found some fault with almost all of them, Mr. Frenzel. There is no question but what the quotas have cost the consumer a great deal. The problem with most of the studies that have been done is that they rely on base price, that is, the sticker price of the car, as though that were the transaction

amount, and we know that in the case of Japanese cars, that is simply not so. Japanese cars are selling anywhere from $500 to $2,000 over the sticker price. The same is now true of many types of domestic automobiles, which are in scarce supply, as the manufacturers have followed the policy, really, of scarcity. That skews all of these results substantially.

They also don't take into effect the price effects of the ending of rebates, the ending of discounts, the ending of subsidized interest rates. All of those are in essence price increases, which are not reflected in any of these studies. I think a really accurate study of what the consumer is actually paying as a consequence of the quotas would probably be staggering to most people, particularly if you include the fact that by driving low-end buyers into the used car market, used-car prices have doubled since 1981. By forcing people to repair old cars that they otherwise would have traded in, the cost of consumer expenditures on auto repairs is up by $17 billion a year since 1980—all of these things should be factored in. But I have seen no study that does it.

Mr. FRENZEL. I have the same feeling you do. I recently had to help a foolish member of my family who asked for my help in buying an automobile. It probably cost her a thousand bucks. In the particular market that we were in, we were not able to buy an American mid-sized, medium-priced car at sticker price, and obviously that has changed enormously since the imposition of the voluntary restraint. My guess is that Mr. Crandall may have about half of the difference categorized

Chairman GIBBONS. I don't think I understood what you said. You couldn't buy an American automobile at sticker price?

Mr. FRENZEL. That is correct. It happened to be in your State, Mr. Chairman.

Chairman GIBBONS. We have been gouging Yankees down there for years but I didn't know we had done it that much.

Mr. FRENZEL. If I could have gotten the accent right, I might have done better. The answer is, you can't go by the manufacturer's list price, and simply add the increases over the 4 years. You have got to take into account what you buy at with respect to the list price, what happens to the trade-in, what happens to the rebates, what happens to the alleged interest reductions. I don't think there exists any study that sophisticated. You guys ought to know. You sell the darn things.

Mr. MCELWAINE. I agree with you absolutely. I think all of the studies here seriously underestimated the actual effect.

Chairman GIBBONS. You are saying you can't buy a car down in Florida for the sticker price?

Mr. FRENZEL. Yes.

Chairman GIBBONS. And you are saying that the ITC study show a cost of $190,000 per job saved per year. You could have a pretty good Florida vacation on that. We could give them a car too.

I am trying to go back to this $190,000 ITC figure. It is your belief, Mr. McElwaine, that that is low?

Mr. MCELWAINE. I think it is extremely low, because I don't think the quotas actually created any jobs at all. I think quite the reverse. According to the Wharton study, by raising the price of

automobiles the quotas did more to depress the volume of automobile sales than any other single factor in the last 4 years.

Chairman GIBBONS. Then why does the UAW support quotas?

Mr. MCELWAINE. I think they are seriously misguided. I think an end to the quotas is going to see an increase in employment, and if we just have a year to experiment with the free enterprise system, somebody might find out it works.

Chairman GIBBONS. I would like to get you two fellows on the same panel together and work that one out. Maybe we can do that when the UAW comes in.

Mr. HORVATH. Mr. Chairman, I would like to point out that the average used car in the marketplace is 7½ years old, and there are people out there that would just love to buy an automobile but they are too expensive, and when this free competition is going to work, you will see less expensive Toyotas and American cars, and they will be able to afford to buy a car, and employment should go up.

Mr. FRENZEL. Would you give your name for the record.

Mr. HORVATH. My name is Steve Horvath.

Mr. FRENZEL. Yes. Mr. Chairman, if the voluntary restraints go off, I may trade in my 1971 Mustang.

Mr. CRANE. I have a 1975 Vega that I might trade in.

Mr. FRENZEL. I am not sure the American producers want me to drive another one of their cars.

Chairman GIBBONS. I am going to top both of you. I have a 1968 Chevrolet sitting right outside the door here that I can't get anybody to tow away. I have offered it for $50 and I have offered it for nothing and I can't get anybody to tow it away. I am going to have to tow it away myself.

Mr. CRANE. Mr. Chairman, you didn't have the foresight to buy a classic antique car as I did. The junkyard wants mine just to cannibalize.

Mr. FRENZEL. Mr. Chairman, to proceed with another question, we have not had any direct testimony, but a number of our witnesses have inferred that the Japanese auto market is denied to us by high tariffs or by various nontariff, other nontariff pressures, and this committee itself has certified on a number of occasions, or at least alleged in its own reports, that that isn't the case, and it is really that American producers do not make the car for the Japanese market, and really have never done so.

Can you shed some light to clear up our record on that point?

Mr. MCELWAINE. We have been through this exercise, Mr. Frenzel, you and me, on previous occasions, I think. The truth is that the Japanese have no quotas on American automobiles, and we have had quotas on Japanese automobiles. They have no tariff on either automobiles or trucks. We have a 25-percent duty on trucks, the highest duty charged on trucks by any industrialized nation in the world. We have a discriminatory 2.8-percent duty on automobiles, which is not charged our domestic manufacturers when they bring their imports in from Canada.

There are no subsidies offered the Japanese auto manufacturers by their Government. Nobody bailed out the Mazda Corp. when it was about to go under. They saved themselves. In short, I think the Japanese market is far less protected than the American market.

A great deal has been said about the Japanese safety and emissions inspection systems. The Japanese changed that significantly in recent years, where they now offer type certification, whereby a manufacturer who has a prototype inspected and it meets Japanese specifications, may then bring in that particular type and body in without inspection.

Volkswagen, Mercedes Benz, BMW's, all have type certification, and just last month, lo and behold, a U.S. manufacturer applied for type certification and it was granted. And do you know what car it was granted on? The Cadillac, not any small car that might be sold in volume, but the Cadillac, for a country where the average street is 12 feet wide. I found that an astonishing development.

Mr. FRENZEL. Is it not true that most of the cars we sell in Japan are curios?

Mr. MCELWAINE. Pretty much. They all have left-hand drive for people who drive on the wrong side of the street, according to our standards. They are mostly too large for those small Japanese streets. You can imagine in Tokyo traffic what it is like to try to pull out and pass in a car where the steering wheel is on the left-hand side and you have got to pass the car in front of you on the left-hand side.

They have made no effort to develop the Japanese market. With General Motors practically the controlling stockholder in Isuzu, Ford the largest shareholder in Mazda, and Chrysler with a significant interest in Mitsubishi, I don't think they have any incentive to export to that market. They are doing very well within that market through their affiliates.

Mr. FRENZEL. Thank you.

I wonder if you would state again—this is my last question—you had indicated that if the quotas were removed, it was likely that the resulting competition would increase the sales of both imported and domestic cars. Is that your impression, that if we liberate the market, we are going to sell more of each?

Mr. MCELWAINE. There is an economics law called the elasticity of price demand, which, if it hasn't been repealed, should see to it that lowering prices would increase volume. We have already seen two examples of price cutting, in my estimate in anticipation of an end to the VRA. I think that is just the beginning. I think we are going to see significant price-cutting at the bottom end of the market, and consequently enlarged sales, more employment, more use of supplies and components by the manufacturers.

Mr. FRENZEL. Thank you. Mr. Nield.

Mr. NIELD. That is my view as well, Mr. Congressman.

Mr. FRENZEL. Thank you. Maybe you can lure me out of my 1971 Mustang before the year is out.

Mr. Chairman, I again thank the witnesses, and I yield my time.

Chairman GIBBONS. We were talking about auto fuel efficiency, the CAFE standards. One of the things that has worried me is that we seem to be more dependent upon imported oil today than we were a few years ago. I am reciting now some figures off the top of my head that I saw this last weekend. Mr. Iacocca reported that we were importing $63 billion worth of foreign oil now, where in 1980 we were only importing $62 billion worth of foreign oil.

In your opinion—you are in the automobile business—have the fuel efficiency standards really made any impact upon fuel efficiency, or is it something else?

Mr. NIELD. It is my view that they have made a very significant impact on fuel consumed by motor vehicles. The point I was making earlier was that that improvement has been due to the designed-in efficiency of vehicles to do the job that the public wants done with the vehicles that they buy.

My concern is that they have gone nearly as far as improvement in efficiency will take them, and from this point forward it would have to be limiting the capacity of the vehicle to do what the consumer needs the vehicle to do. They would have to either be smaller, with less occupant space, or trailer-towing capacity. The efficiency limit itself, making the engine computer controlled, and so forth, has pretty much been reached.

Chairman GIBBONS. What you are saying is the companies have gotten about all they can get out of the engine. What they would have to do now is reduce the weight of the car.

Mr. NIELD. That is correct.

Chairman GIBBONS. And that means fewer seats, less carrying capacity, and things of that sort?

Mr. NIELD. And, of course, what it also might mean is that a person with a 16-mile-per-gallon car might feel that he has to keep that old car because none of the new cars will have the capacity that he needs to meet his personal needs. And so then you are comparing 16 miles per gallon with maybe 26 miles per gallon, which is feasible at this point, rather than going to 27½, which the current law now requires.

Mr. MCELWAINE. I do think, Mr. Chairman, a far more efficient regulator of the manufacturers in producing fuel efficient cars has simply been the price of fuel.

Chairman GIBBONS. I agree. I tried to get them to go that way, but I couldn't persuade the people to do it that way.

I thank all of you gentlemen for coming today. As always, your testimony is very enlightening, and you have helped us to understand the problem. We appreciate your continually being out there fighting for your share of the American market.

This concludes the hearings, with the exception that I made for the UAW. We will keep the record open until March 6 for additions, corrections, or anything else that has to come in. Thank you very much.

Mr. NIELD. Thank you, Mr. Chairman.

[Whereupon, at 4:25 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT OF THE AMERICAN ASSOCIATION OF EXPORTERS AND IMPORTERS

In May of 1981, the Japanese Government signed a "voluntary" restraint agreement (VRA) with the U.S. that limited Japanese automobile exports to 1.68 million units per year for three years (effective April 1 of each year) with the third year's quota to be determined by an evaluation of the market situation at that time. Although the measure was labeled as "temporary," the VRA was renewed for a fourth year with an increased ceiling of only 170,000 cars. This current VRA is set to expire on March 31 in the midst of record budget and trade deficits.

Protectionist feeling is strong in Congress and there have been numerous calls to continue the VRA with Japan, even though the U.S. auto industry is enjoying

record profits. The American Association of Exporters and Importers believes that to extend the VRA is to protect an increasingly healthy and profitable industry, at the expense of the American consumer. Protection of a healthy domestic industry is a dangerous precedent that will lead to the contraction of world trade.

The American Association of Exporters and Importers is a national organization comprised of approximately 1100 U.S. firms involved in every facet of international trade. Our members are active in importing and exporting a broad range of products including chemicals, machinery, electronics, textiles and apparel, footwear, foodstuffs, automobiles and wines. Association members are also involved in the service industries which serve the trade community such as customs brokers, freight forwarders, banks, attorneys and insurance carriers.

The VRA with Japan was hardly "voluntary." In the face of sagging U.S. automobile sales and production, and massive autoworker layoffs, Congress, at the prompting of U.S. auto manufacturers and workers, was considering measures to restrict imports. Japan was confronted with a Hobson's Choice: Quotas installed with their input or quotas installed by the U.S. unilaterally.

The VRA was "negotiated" based on the belief that the U.S. auto industry needed "breathing space" to regain their competitiveness. After four years of relief from competition there is no doubt that the domestic auto industry has recovered. In 1984, a record profit of approximately $10 billion was earned by the domestic industry. Total monthly sales of new cares are up over last year and seem to be increasing. The auto industry executives gave themselves record bonuses and a new labor contract was signed that raised compensation for the autoworker still higher.

The U.S. auto industry has recovered but the cost for the revival has been high. Last year, Robert Crandall of the Brookings Institute, in testimony before the Senate, estimated that only 40-50,000 jobs had been saved at a cost to the American consumer of $100,000 per job saved. Recently released studies by the International Trade Commission (ITC) and the Federal Trade Commission (FTC) paint a more costly picture. The ITC estimated that the automobile quotas saved or generated 44,000 jobs in 1984, but costs consumers $8.5 billion. That is a cost of approximately $198,000 per job saved. The FTC estimated that only 4,600 jobs would have been lost in 1981, at a yearly cost of $1.1 billion. That is a cost of $240,000 per job saved. The U.S. autoworker is already paid 60% more than the average manufacturing worker in the U.S. What has resulted is a massive subsidy to the now healthy auto industry by the U.S. consumer.

The U.S. auto industry was not the only beneficiary of the quota. Ironically, the Japanese made at least $2 billion annually of income, over and above what they would have made, because the quota limited supply and allowed the dealers to sell their cars above the list price.

The consumer is not the only loser. The U.S. industry is operating in a non-competitive vacuum. Removal of the VRA now would act as catalyst for the domestic industry to improve quality and to competitively price their cars. The continued restrictions on imports will not convince the American Public that the U.S. auto is a better product and one worth purchasing. Only a return to competition between the foreign and domestic automobile industries will ensure quality and spur economic expansion.

The President's Cabinet Council on Commerce and Trade (CCCT) recently advised the President to leave the decision, on whether to allow the VRA to expire, to the Japanese. We believe that, in this case, inaction by the U.S. government would be just as effective as action. The important point is to allow competition to exist unfettered by quotas.

The lifting of the quota is viewed by some to be the end of the U.S. auto industry. Such dramatic exaggeration is hardly supportable. Recent Commerce Department projections show that U.S. producers would retain their sales volume while imports' market share would gradually increase from approximately 23 percent to 30 percent in 1989 if quotas were lifted. An increase of 7 percent over four years hardly would signal the demise of the U.S. industry. And the 7 percent increase does not even take into consideration U.S. industries' aggressive, innovative responses to small-car competition, such as G.M.'s Saturn project.

Then there are those, like Senators Danforth and Boren and Representative Michel who now wish to link the VRA cross-sectorally with increased U.S. access to the Japanese market. The unquantifiable restrictions found in the last paragraph of the Resolution imply that the Congressman wish that the VRA will no longer hinge on the health of the U.S. auto industry but it will "not be ended until United States exports to Japan are *substantially increased* and the United States trade deficit with Japan is *substantially reduced*" (emphasis added). The intent of the Congressman is well-placed. AAEI believes that the further opening of the Japanese market

will help to expand world trade, and in particular, help to reduce the U.S. trade deficit. However, using the VRA as a club to force our trading partner to widen their markets is wrong. As the $2 billion annual price enhancement figure given previously indicates, the VRA is not exactly hurting the Japanese. Therefore if cross-sectoral reciprocity as suggested by Messrs. Danforth, Boren, Michel were practical, Japan could just as easily lean back and allow the VRA to expire, without allowing any greater access to their home market.

AAEI is certain that the U.S. consumer will not and does not enjoy subsidizing a healthy U.S. industry so that we can toss empty threats at our trading partners. The trade deficit can be reduced not by bullying tactics, but by bringing down the value of the dollar allowing U.S. exporters a greater chance to further penetrate foreign markets.

AAEI believes that the VRA with Japan must not be renewed. The VRA has accomplished its original purpose; the U.S. auto industry has received its "breathing space". The industry, its executives and workers are all enjoying a record year and the accompanying profits. The cost to the U.S. consumer is far too great to allow the prosperous U.S. auto industry to exist in an artificial, non-competitive environment. The American Association of Exporters and Importers urges an end to the VRA with Japan and a return to an anti-protectionist, pro-competitive environment in world trade for automobiles.

STATEMENT OF AMERICAN MOTORS CORP.

President Reagan recently announced that he will not request the Japanese automotive manufacturers to continue the Voluntary Restraint Agreement (VRA) on automobile experts beyond the expiration date of March 31, 1985. Nevertheless, the need for some form of restraint remains critical. Until the three fundamental issues in U.S.-Japanese trade relations discussed below are resolved, Japanese automakers must continue to exercise restraint in their exports to the United States. To date, the Japanese government has shown little inclination to address those issues in a meaningful way. Therefore, we strongly urge the Congress to send a clear and direct message to Japan that the United States cannot and will not tolerate a flooding of the U.S. automobile market after the VRA expires.

The three unresolved issues in U.S. bilateral trade relations with Japan are (1) the disparity in the yen/dollar exchange rate, (2) failure by the Japanese Government to open its home markets to U.S. goods and services, and (3) the record high trade deficit.

1. Altering the artificially low yen/dollar rate

Japanese manufacturers enjoy an average cost advantage of up to $1,200 on each car they sell in the U.S. market because the yen has been held at an artificially low value against the U.S. dollar. Until that exchange rate advantage is removed, export restraint by Japanese automakers is critical to ensuring that the U.S. automobile industry can remain competitive, particularly with small cars which are highly price sensitive. The Japanese exchange rate cost advantage continues to increase despite a major agreement reached with the Japanese Government to strengthen the yen. Since the agreement was signed in May 1984, the yen's value actually has declined by an additional 10 percent and is currently at its weakest level in two years (260:1).

2. Opening Japanese markets to U.S. goods and services

Japan's refusal to open its home markets to U.S. products and services is causing the loss of thousands of jobs in this country's basic industries and is adding billions of dollars to the trade deficit. The plain fact is that their markets remain firmly closed to most U.S. exports. Competitive American products simply do not have access to Japanese markets while Japanese products of all types flood into the United States. This is not fair or free trade—it's a one-way street.

3. Balancing the record high U.S. trade deficit with Japan

The overall United States trade deficit was $123 billion in 1984. The bilateral trade deficit with Japan alone accounted for $37 billion of the overall total. Flooding of the U.S. automobile market with Japanese imports would add billions more to the bilateral trade deficit with Japan, resulting in reduced U.S. employment and even heavier pressures on the budgetary deficit. This is especially critical because there is no prospect in the near term for a major increase in U.S. exports to Japan mostly due to the artificially weak yen.

High interest rates and the recession had a severe impact on the U.S automotive industry in 1981-82, causing sales to fall far short of industry expectations and reaching the lowest levels since the Great Depression of the 1930's. Although the U.S. automotive industry's recent recovery has been substantial, it remains fragile, especially for American Motors Corporation (AMC). AMC needs a chance to put its recovery on a sound footing to fulfill its commitment to major capital investments in modern technology and new products.

AMC spent $800 million in the 1981-1983 period on high technology equipment and tooling for our new products and for a substantial upgrading of company facilities. AMC's new passenger car and four-wheel-drive products are competitive with domestic and Japanese vehicles, including the highly important areas of fuel economy and product quality. We are meeting the challenge to produce higher quality, more fuel efficient vehicles; however, we still have much further to go.

Our company's 1984 profit was modest $15.5 million. The company is highly leveraged as a result of investment product made to date. To improve our market position further, AMC's capital expenditure program involves a major expansion of our product offerings over the next four years. The company will compete in more than 60 percent of the passenger car market by 1988 compared with approximately 20 percent currently. AMC also will enter the two-wheel-drive light-truck market and will substantially expand coverage in the four-wheel-drive market by 1986. Achieving these goals requires further massive capital investment, but significant erosion in passenger car sales, limited currently to small, fuel efficient vehicles, could seriously affect the company's ability to execute its new product programs.

It would be a serious mistake to assume that Japanese automakers will practice restraint after the VRA is lifted. A number of Japanese manufacturers—Suzuki, Isuzu and Mitsubishi, to name three—were held to levels under the VRA far short of what they could produce and export to the U.S. All of the major Japanese automakers have full cooperation from the Japanese Government which has and continues to push hard for exports. The Japanese automotive industry has the yen/dollar exchange cost advantage, available productive capacity and every incentive to increase their penetration in the U.S. car market, particularly in the smaller, fuel-efficient vehicle segment where price sensitivity is acute. It is naive to believe that there will not be a sharp increase in Japanese small car sales in the United States if the current conditions remain unchecked.

Ambassador Brock recently testified before the Joint Economic Committee that removal of the VRA could enable Japan to increase its U.S. sales by 750,000 cars by early 1986. This would force some U.S. manufacturers back into a recession, resulting in reductions in U.S. capital investments, increased unemployment and further offshore sourcing. It would effectively eliminate whatever incentives domestic manufacturers have to continue to produce small fuel-efficient cars in the United States, and would be particularly damaging to AMC, currently a small car "specialist."

In summary, U.S. car manufacturers have stepped up to both the public and governmental mandate with regard to quality and fuel efficiency. But the U.S. automotive industry alone cannot deal with unrestricted Japanese access to the small car market in view of the artificially low yen. Action by the U.S. Government must address this problem. In the meantime, it is incomprehensible why our government should "encourage" greater Japanese imports by letting the VRA expire when the likelihood of increased U.S. exports to Japan is remote and Japan's track record on bilateral trade is so dismal.

The Japanese must understand that U.S. basic industries cannot be eroded further. With the President's decision not to seek a continuation of the VRA, what alternatives are available to convey this message? First, this subcommittee, and the Congress as a whole, should overwhelmingly support a strongly worded resolution, such as the Michael-Danforth resolution, calling on the Japanese automakers to exercise export restraint until the three fundamental issues in U.S.-Japanese trade relations are resolved. Such a statement on the part of the Congress would send an unmistakable message to the Japanese Government that we mean business.

Second, if the Japanese Government fails to heed that warning, we would hope that members of Congress would support and seek enactment of H.R. 1050. This bill, introduced by Representative John Dingell, would impose a 15 percent quota on automobiles imported into the United States. With the prospect of a substantial increase in Japanese car imports, this legislation would preserve our industrial base until the Japanese Government and the Japanese auto industry so closely tied to that government choose to act responsibly.

DEANE, SNOWDON, SHUTLER & GHERARDI,
Washington, DC, March 4, 1985.

Hon. SAM M. GIBBONS,
Chairman, Trade Subcommittee, U.S. House of Representatives, Longworth House Office Building, Washington, DC.

DEAR MR. CHAIRMAN: This letter has been written on behalf of the Auto Internacional Association. This Association represents over three hundred importers, exporters, manufacturers, representatives and distributors of parts and accessories for imported vehicles. This letter constitutes the Association's written comments concerning the hearings before your Subcommittee on the Japanese Voluntary Restraints Agreement. We request that this testimony be made a part of the record of those proceedings.

Auto Internacional Association has as one of its primary purposes the enhancement and preservation of free trade between the United States and its trading partners. Based upon this fundamental principal, the Association cannot support Congressional actions aimed at extending the voluntary restraints on Japanese imports, or substituting protectionist legislation in place of such restraints. It now appears that President Reagan will not specifically press for the restraints which are the subject of these hearings before your Subcommittee. Instead, he has stated that his Administration will take more constructive action on the trade deficit problem by incorporatiang automobiles into ongoing trade discussions with Japan. It is, therefore, left largely to Congress to decide whether there should be an artificial barrier to imported vehicles erected around the U.S. marketplace. We urge the Members of this Subcommittee and the other Members of Congress to resist the calls for protectionist legislation which will surely occur with the loosening or removal of the Restraints.

The Association asks that the Congress rely upon the current strength of the economy and the position of the United States as a leader in free trade, when considering whether to enact protective measures such as quotas or so-called local content bills. These legislative measures are not warranted at this time, and pose a grave threat to the continued strength of the U.S. economy.

The economic climate when the Restraints began was vastly different than the climate today. The U.S. economy is now healthy and continues on an upswing. The vehicle manufacturing industry in the U.S. has benefited from this upswing and has boasted of record profits and increases in efficiency. On the other hand, the Voluntary Restraints cost the U.S. consumer 15.7 billion dollars in 1981–1984, as reported by the United States International Trade Commission's Preliminary Report to this Subcommittee. This is a heavy subsidy and should not be required where the U.S. vehicle manufacturers have regained their competitive position and are enjoying large profits.

We urge this Subcommittee to recommend that no legislative measures be taken which either extend or replace the Japanese Voluntary Restraints. We believe strongly that such legislative measures would not only injure the American public and all U.S. export industries, but would cause irreparable harm to our industry, with its 3,000 businesses supporting 100,000 Americans.

Sincerely,

STEVEN T. MILLER,
Counsel, Auto Internacional Association.

STATEMENT OF RICHARD H. FINK, PRESIDENT, CITIZENS FOR A SOUND ECONOMY

Mr. Chairman and members of the committee, my name if Richard H. Fink. I am president of Citizens for a Sound Economy, a public-interest advocacy group dedicated to returning economic decision-making to citizens. With an active membership of 40,000 citizens, CSE promotes policy and educational initiatives in the areas of international trade, privatization of government services, Social Security, and tax reform.

Let me begin by expressing appreciation to the committee for holding hearings on the important issue of automobile import restraints. However, at the risk of sounding ungrateful, let me add that we are disappointed that congressional hearings held on this subject, including this one today, have not given time to the primary victim of trade restraints—American consumers. It would have been worthwhile for you to listen to the victims of protectionist policies in person. In any event, I thank the committee for allowing us to submit written testimony.

According to many studies, including an analysis commissioned by Citizens for a Sound Ecomony, auto restraints have exacted a heavy price in terms of costs to

American consumers and lost jobs in the American economy. Our study cites figures that show the VRA has raised the average price of a domestic car by $400 and the average price of a Japanese car $1,000. Furthermore, the total cost to consumers over the four years has been more than $10 billion. The International Trade Commission just last week estimated the cost at $15.7 billion.

What has led to this huge consumer bill? The restraints have enabled both American and Japanese automakers to raise prices artificially. Since the Japanese are legally limited in the number of cars they can export, they naturally send the most expensive cars. Before the restraints, a budget-conscious consumer could forgo flashy optional equipment and keep the price down. Today he is likely to find only fully equipped, top of the line models. The American firms have been able to raise prices simply because pressure from the Japanese has been legally reduced. The result is that American consumers have to pay higher prices, while choosing from a shrunken array of cars.

It is evident that not since the Arab oil embargo of more than a decade ago has the consumer suffered from such anticompetitive behavior as the auto import restraints. Sadly, the primary culprits in this case are not foreign governments, but the U.S. government, bowing to the pressure of two domestic automakers and a labor union.

What benefits are supposed to have accrued from this consumer sacrifice? We have been told the restraints are necessary to save auto workers' jobs and put U.S. automakers back on their feet. But the CSE Issue Analysis points out that capital investment by the automakers fell during the VRA period. It goes on to note that jobs saved were more than offset by jobs lost in American export industries and in firms that deal in auto imports. It is only common sense: If the Japanese have their revenues from exports cut, they have fewer dollars to spend on American products. This hurts American farmers and other U.S. exporters.

The supporters of continued protection from auto imports argue that the restraints are necessary because of a strong dollar. However, a strong dollar is the sign of a healthy economy. The dollar can never be too strong. A strong dollar attracts foreign investment in the U.S. economy, creating jobs and prosperity. A strong dollar helps American producers who import raw materials. A strong dollar benefits American consumers. Rather than call for weakening the dollar of protecting less competitive firms from the effects of a strong dollar, we should let the market direct resources to their most efficient uses.

Ironically, domestic automakers complain that a strong dollar is at the root of their problem. But restrictions on imports reduce the flow of dollars abroad, making them more scarce in world currency markets. This artificially increases the dollar's value against other currencies.

Our Issue Analysis, however, does not take only the outo industry to task. It points out that government regulation has made it difficult for American firms to compete effectively in world markets. But the solution is not protection: It is repeal of offending regulations. These include energy standards and antitrust laws, which hog-tie American companies and, in turn, harm consumers.

Our affiliate, the Council for a Competitive Economy, has been fighting against auto-industry protectionism since 1980. In testimony before the International Trade Commission that year, we called the request for restraints an attempt to "thwart the American consumer," by raising prices and limiting choices. We were right. The VRA has been detrimental to everyone, even domestic firms and workers, because it has put off the day of reckoning—the day when they would understand that shelter from competition is no long-term solution to their problems.

I would like to make one final point: as the members of this committee realize, protectionist sentiment has reached alarming levels lately. the result has been increased tension with our trading partners. In fact, even if auto restraints aren't extended, it is clear taht the Japanese will be cajoled, treatened—or worse—into exercising restraint. This will not be in our interest. Therefore, I urge Congress to take action—perhaps through a sense of the Congress to take action—perhaps through a sense of the Congress resolution—to defuse protectionist sentiment and improve trade relations with Japan. Regretably, the Japanese government practices protectionism. But erecting our own trade barriers, creates additional victims—in this case, American consumers and everyone in this country who is looking for new economic opportunities.

I trust that CSE's Issue Analysis, as well as virtually every study done on the subject, will persuade you that the continuation of restrictions on auto imports would be a tragic mistake for which American consumers will pay dearly. We must stop protecting the American auto industry from the American consumer.

Thank you.

Issue Analysis: the Voluntary Restraint Agreement: the Consumers' Perspective

(By Robert Tollison and Peter Boettke)*

INTRODUCTION

Until the late 1970s, American automobile manufacturers had little to worry about from outside competition. One reason for this was the unique American preference for large cars, supported by a gasoline price one-half that of the world price.[1] Even after the first "oil crisis" in 1973, Americans continued to purchase large cars. As late as 1978, subcompacts comprised less that 25 percent of new-car sales in the U.S.[2]

After the Iranian revolution and the second "oil crisis" of 1978, however, American consumers began to change their tastes. And they caught the American auto industry unprepared. The fuel economy of American cars was 23 percent less than that of imports.[3]

Besides the shift in consumer preferences, many other factors helped cripple the American auto industry. To cope with this industry-wide collapse, auto manaufacturers, the United Auto Workers (UAW), and congressmen with constituents involved in the domestic industry began to lobby for "breathing space." They called for import quotas against foreign competition, specifically the Japan's Ministry of International Trade and Industry (MITI) agreed on May 1, 1981, to a three-year "voluntary" restraint agreement (VRA).

During that time, the American auto industry has rebounded astonishingly. On March 31, 1985, the restrictions are scheduled to be lifted. Though the American industry is making record profits, considerable effort and resources have been devoted to extending the restraint agreement for at least another year.

The auto manufacturers and UAW often claim that American jobs are at stake and that a vital sector of the economy is being threatened by outsiders. This study will examine those claims and the effects of the restraints on both the auto industry and American consumers.

WHY THE FALL?

Beginning in 1979, the economy suffered the worst recession since the Great Depression. Though there was an upturn in 1980, the circumstances harming the auto industry did not improve. Between 1978 and 1982, finance rates for new-car sales rose from 12.1 percent to 16.7 percent, gasoline prices increased sharply, and new-car prices rose by more than 50 percent.[4] From 1979 to 1982, 1.1 million sales were lost annually as incomes fell and unemployment rose. Of these, 300,000 lost sales have been attributed to higher interest rates, 340,000 to gasoline-price increases, and 480,000 to new-car price increases.[5]

Almost the entire collapse of the domestic auto industry can be accounted for by changing consumer preferences in the face of new and more costly conditions and the consequent demise of the dominant mid-to-large-car market. Of the estimated 3.3 million sales lost between 1979 and 1982, 2.7 million are credited to this collapse. The gain by domestic and foreign subcompacts occurred in a shrinking market. "The U.S. auto industry's severe losses in sales, jobs, and profits in recent years have been caused by economic factors, not imports."[6]

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*Robert Tollison is director of the Center for the Study of Public Choice and professor of economics at George Mason University, Fairfax, Virginia. He was formerly director of the Bureau of Economics at the Federal Trade Commission.

Peter Boettke is a fellow of the center for the Study of Market Processes at George Mason University.

[1] For an excellent discussion of why the U.S. gasoline price was so low and of the consequences of this with regard to the establishment of OPEC and the oil shortages in the 1970s, see George Reisman, The Government Against the Economy, Thornwood, NY: Caroline House Publishers Inc., 1979, pp. 89-95.

[2] MVMA Motor Vehicle Facts and Figures: '84, Motor Vehicle Manufacturers Association, 1984, p. 16.

[3] "Ending Auto Quotas: A Return to Competition," Automobile Importers of America, Inc., November 30, 1984, p.3.

[4] "Impact of Local Content Legislation on U.S. and World Economies," Wharton Econometric Forecasting Associates, July 1983, p. 3.

[5] Ibid, p. 4.

[6] Ibid, p. 3.

In 1980 the bottom fell out for the U.S. auto manufacturers; on sales of 6.3 million cars, the "Big Three" automakers lost $4 billion. The worst year in the industry's history was recorded as its profit rate fell to a negative 9.3 percent, 23 percentage points below the average for all manufacturing.[7] On top of the oil shock, the surge in imports, and the automakers' efforts to downsize their models, the government began to introduce stricter safety and emissions requirements. Though Japanese imports were also subject to these requirements, they may have taken a greater toll on the domestic firms because the Japanese did not need to downsize at the same time.[8]

Furthermore, the new regulatory standards increased the price of a new car at least $1000 and reduced both fuel economy and performance. As a result of this jump in price, the demand for new cars dropped.[9]

In 1980, the worst financial year in domestic auto history, Detroit pleaded for import restrictions. The UAW and Ford Motor Company filed a case for restrictions with the International Trade Commission (ITC). But the ITC said no, ruling that the industry's problems were a downturn in the economy and a shift in consumer demand, rather than foreign competition. The Commission concluded that had the auto industry been able to take advantage of the consumer shift to smaller cars, it could have increased sales by some 400 percent.

Having lost at the ITC, Ford, Chrysler, and the UAW pressured Congress to provide temporary "breathing space." In the spring of 1981 Senators John Danforth (R-Mo.) and Lloyd Bentsen (D-Tex.) introduced a bill to impose mandatory quotas. The Reagan Administration opposed it. Nevertheless, President Reagan assigned U.S. Trade Representative William Brock to persuade the Japanese government to institute its own export restraints.

THE VRA: TERMS AND CONSEQUENCES

The resulting "voluntary restraint agreement" was called a temporary measure to help get the American auto industry "moving again." The agreement provided for two years of restrictions and an additional year of monitoring. But the terms soon changed. Outright restrictions are in their fourth year. During the first three years, annual Japanese exports to the U.S. were limited to 1.68 million cars. When the agreement was extended to the fourth year, the number was increased to 1.85 million.

We are constantly reminded how the VRA has saved American jobs and made America competitive again.[10] Economic theory, however, exposes these arguments as fallacies and unveils the immense costs to consumers.

Since Adam Smith, economists have presented the case for free trade thousands of times. As Smith himself put it:

> In every country it always is and must be the interest of the great body of the people to buy whatever they want of those who sell it cheapest. . . . The proposition is so very manifest that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question, had not the interested sophistry of merchants and manufacturers confounded the common-sense of mankind.

The business people of Smith's day were simply reacting to an institutional environment that rewarded protection-seeking, rather than rivalrous competition.[11] These economic incentives were established by social and political institutions. It is similar with auto manufacturers today. As long as seeking protectionist policies is more profitable than competing in an open market, that is the path they will take.

One of the first fallacies to be exposed is that protectionist policies save American jobs. Of course, some jobs are saved, but what of the jobs destroyed and those that would have been created had the quotas not been adopted?[12] Furthermore, what are the costs to consumers of savings these jobs?

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[7] Robert W. Crandall, "Import Quotas and the Automobile Industry: The Costs of Protectionism," The Brookings Review, Summer 1984, p. 9.

[8] Ibid, p. 10, and MVMA, p. 42.

[9] "Import Quotas," p. 10.

[10] Ed Crane, "Lee Iacocca Wants to Sell You a Lemon," Inquiry, May 1984, pp. 18–23.

[11] Barry Baysinger, Robert B. Ekelund, Jr., and Robert Tollison, "Mercantilism as a Rent-Seeking Society," in Toward a Theory of the Rent-Seeking Society, edited by James M. Buchanan, Robert Tollison, and Gordon Tullock, College Station, Texas: Texas A&M University, 1980, pp. 235–268.

[12] The interesting and important questions that an economist must attempt to answer center on that which is unseen. Emphasis must be placed on explaining the unintended consequences of economic policies.

The American auto industry had a good year in 1983. As the Motor Vehicle Manufacturers Association (MVMA) recently reported:

Everybody has benefited. Some 860,000 auto employees took home paychecks from the industry in the first quarter of this year (1984), representing an increase of 154,000 from just a year ago. Unemployment of 7.8 percent, or 98,000 people, was about half the level of a year earlier.[13]

But the question remains: Is it worth the subsidy consumers and workers have been compelled to provide? Concentrating only on the VRA's price effects, Robert Crandall of the Brookings Institution estimates that the cost to the American consumer for each job saved is nearly $160,000 per year. "Employment creation at this cost," he concludes, "is surely not worth the candle." [14] Furthermore, Crandall says his figures are conservative; thus the cost to consumers could even be greater.

Wharton Econometrics projects the disastrous effects of continued and more stringent quotas:

> Even assuming optimistically that the lost import sales would be exactly replaced by gains in domestic auto sales, the potential U.S. auto industry employment gains in 1986 are only 39,000 workers, climbing by 1991 to 84,000 workers. . . . Many privately owned imported auto dealerships could be forced into bankruptcy by the sharp drop in imported auto sales. . . . [A]t least 53,000 jobs could be lost within the U.S. businesses associated with imported autos. The potential job losses by 1991 reach 88,000 jobs, which would more than offset the expected job gains within the U.S. auto industry.[15]

Wharton also notes that the possibility of retaliation by the Japanese government against American agricultural and capital-goods exports is grave.[16]

But even without retaliation, thousands of American jobs are jeopardized, because restricted imports reduced the earnings for Japanese workers and investors. They in turn have less to spend for American exports or investment here.

The VRA has brought several other changes and costs that must be made explicit. The first and most recognizable is that it has reduced the supply of Japanese cars. This has caused their price to rise relative to the price of American cars, prompting an increase in demand for U.S.-made autos. This shift in demand has caused an increase in the price of American cars. But we cannot expect these two effects to offset each other and boost sales of new domestic cars. The overall increase in auto prices has caused some people to leave the new-car market completely—leading to increased purchases of used cars—or led them to search for alternatives in non-Japanese imports. The point is that the average price of automobiles (imports and domestics) is higher than it would have been without the restrictions, and so fewer new cars are bought.

In addition, consumers have paid a cost in the form of a narrower range of choice. The restraint agreement has given the Japanese manufacturers an incentive to export only models that yield the highest returns. This leaves American consumers to choose exclusively among relatively luxurious models, loaded with high-priced "optional" equipment.

It is estimated that the import restrictions have raised the average domestic car price by $400 and the average Japanese car price by $1000. The cost to consumers for 1983 alone is estimated to have been between $4.3 billion and $5 billion, not counting the consumer loss from the restriction in choice. [17] Therefore, the overall

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[13] MVMA, p. 2.

[14] "Import Quotas," p. 16.

[15] "Local Content," pp. 9-10. This Wharton Econometric model was set up to predict the possible impact of Local Content Legislation, specifically the local content proposal H.R. 1234 that was being considered at that time (July 1983). The International Trade Commission estimates that in four years of export restraint, some 44,000 auto workers' jobs were saved. (Stuart Auerbach, "Car Quotas Said to Cost Consumers $15.7 Billion," Washington Post, February 15, 1985, p. F1.)

[16] Ibid., p. 10.

[17] This figure utilizes both the Crandall figure of $4.3 billion and Wharton's, which estimates a consumer cost of $5 billion. In addition, Byran and Humpage conclude that the consumer cost due to increased Japanese new-car prices to be approximately $2.7 billion for the three years. Furthermore, they state that "of this total amount, $2.6 billion represents a transfer of purchasing power to producers and dealers of Japanese cars from consumers who continue to buy Japanese cars at artificially high prices." (See Michael F. Byran and Owen F. Humpage. "The Cost of a Protectionist Cure," Economic Commentary, Federal Reserve Bank of Cleveland, July 30, 1984, p. 3).

cost to consumers for four years of restraints can reasonably be estimated at more than $10 billion. Indeed, the ITC recently confirmed this, estimating the cost to consumers at $15.7 billion.[18]

WHY ISN'T THE INDUSTRY COMPETITIVE?

Several factors bear on the American auto manufacturers' problems in competing against the Japanese. Those favoring protectionism commonly claim that the terms of the competition are unfair. Two explanations are given. The first involves the strength of the dollar compared to the yen. It is claimed that this discrepancy makes Japanese cars about $900 cheaper here than they would be if the currency relationship was "fairly" valued. Second, it is claimed that Japan's value-added tax does not apply to exports, unlike the U.S. income tax, giving the Japanese an added cost advantage of $700 per car. Therefore, the argument goes, since Detroit has no control over currency relations or tax policies, import restrictions would insure "fairness."

But these arguments rest on some weak assumptions. If the strength of the dollar were the problem, European cars would have had a greater cost advantage than the Japanese because European currencies have depreciated against the dollar even more than the yen. From July 1980 to October 25, 1984, the dollar rose only 10.8 percent against the yen, but 130 percent against the French franc, 94 percent against the British pound, 74 percent against the German mark, and 127 percent against the Italian lira. Clearly, currency discrepancies cannot explain Japan's success.

The claims regarding the tax advantage are more illusion than fact. Though the value-added tax is rebated to Japanese exporters, "they do pay other domestic taxes, as well as taxes and import duties in the U.S. . . . [A] typical Japanese car sold in this country is actually more heavily taxed than its U.S. counterpart, carrying a tax and duty load of $2,675 vs. $2,088 for an American made car."[19]

The VRA was sought to give U.S. manufacturers a change to retool and cut costs. But though great gains have been made,[20] Detroit still cannot build a cost-competitive small car. The Japanese cost advantage as of 1983 was $1000 to $1500.[21]

Ironically, U.S. manufacturers apparently were adjusting before the restraints were put in place. The manufacturers were concentrating on the small-car market and beginning to make progress. The average weight of a domestic car by 1981 had been reduced 30 percent from the 1973 high. Similarly, cars with four-cylinder engines comprised 40 percent of sales in 1981, against only 9 percent in 1973. Also, fuel economy was increased by more than 25 percent for cars similar to ones produced in 1973. U.S. manufacturers were investing heavily in their operations. Real investment rose by more than 88 percent between 1975 and 1980.[22] But note: "Since 1981, real investment expenditures by the automobile industry have fallen 30 percent." [23]

It would be wrong to say the Japanese have no institutional advantages over American automakers. But the real advantages are rarely mentioned. A major one is in the antitrust area. The laws in Japan, unlike those in the U.S., allow companies to share research-and-development efforts. Japanese companies benefit from "horizontal cooperation," as well as from vertical integration. Japanese corporations also operate in a tax system that allows them to depreciate equipment up to 60 percent during the first year, against only 25 percent for U.S. manufacturers. This provides a strong incentive for Japanese firms to use the latest, most efficient equipment. All of this benefits consumers through greater efficiency.

Another major difference for the Japanese is the pervasiveness of a particular quality-control technique. Quality control has been a problem for U.S. automakers since the 1970s.[24] The Japanese follow a quality-control system referred to as the

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[18] "Ending Auto Quotas," p. 21, and "Car Quotas . . . ."

[19] Anne B. Fisher, "Can Detroit Live Without Quotas?," Fortune, June 25, 1984, p. 23.

[20] The MVMA labels 1983 as the year of "An Historic Turnaround" and it is claimed that:

Certainly, historians will appraise this time as a momentous milestone in the industry's annals. It is a turnaround period following one of the severest slumps ever encountered by any segment of national or even international business.

The most remarkable aspect of the upturn has been its revival in so brief a time. In less than four years a cornerstone of our economy virtually has changed its daily operation, the kind of product if fashions and sells, and its role as an international rather than a national force in the motor vehicle manufacturing world (9184, p. 2).

[21] "Local Content," p. 8.

[22] "Import Quotas," p. 12.

[23] Ibid., p. 12.

[24] Ibid., p. 10.

"Deming Methodology." This system, devised by W. Edwards Deming, uses statistical techniques involving "quality circles" to help improve a firm's production capabilities and product quality. American firms (outside the auto industry) that have adopted the techniques have reported great success.

The biggest Japanese advantage, though, is in the area of labor costs and productivity. American auto workers earned an average of $19 per hour in 1983, against $7.91 for the average Japanese auto worker.[25] The American auto workers' hourly wage is more than 60 percent above the average for all U.S. manufacturing workers. In contrast, the Japanese auto workers' wage is only 25 percent greater than the average Japanese industrial worker.[26]

Besides this wage differential, productivity also varies. The Japanese auto industry is estimated to be 2½ times more productive than the U.S. industry; its productivity is growing at 8 percent a year as manufacturers are increasing automation.[27] If the differences in both wage rates and productivity are considered, the reasons for the Japanese cost advantage are apparent.

In 1983, the U.S. economy improved and total car sales in the U.S. rose 15 percent, to 9.2 million units. The domestic industry captured the majority of the gain, increasing its sales by over a million units from 1982 to 1983. General Motors recorded profits of $3.7 billion, Ford $1.9 billion, and Chrysler $0.7 billion, for a total of $6.3 billion in industry profits for 1983. It is easy to see why profits were up: The companies cut costs because they were under the threat of an eventual return to competition, but they raised prices because of the protection.

In 1984, U.S. automakers recorded their best year since 1979. Car sales were up 17 percent over 1983. Ford was the pacesetter, posting a 26-percent increase over 1983 sales. GM increased sales by 13.2 percent over 1983, and Chrysler topped 1983 sales by 17.3 percent. On February 15, 1985, Chrysler announced its highest profits in its 60-year history, $4.2 billion.[28] The year's profits for the three firms are projected between $10 billion and $11 billion.

In addition to the increased demand for new cars, the cost structure of the industry has changed dramatically. Chrysler, for example, has been able to reduce its break-even point to 1.1 million units; in 1980 it was 2.4 million units. However, the high profits bestowed by the import restrictions have relaxed the pressure for the wage restraint needed to be cost competitive. Huge executive bonuses were paid in 1983. GM Chairman Roger Smith was granted $866,000 in bonuses for 1983, besides his $625,000 salary. Ford Chairman Philip Caldwell received a $900,000 cash bonus on top of his $520,000 salary. It is hard to believe that an industry capable of paying such bonuses is in need of protection.

The vital point is that these bonuses have increased the leverage of the UAW, which will likely be back at the negotiating table demanding more of the pie. As Crandall concludes:

> Indeed, because they have produced high profits in the industry, the [VRA] may actually lead to a widening of this wage differential between auto workers and the average American manufacturing employee. . . . If that happens, the political necessity for quotas will increase, and future presidents will have difficulty arguing that the domestic automobile industry should once again face the rigors of international competition.[29]

The restrictions have given the domestic industry some "breathing space," but in the process they have distorted the market at the consumers' expense. When production is artificially limited to less efficient producers, real resources are lost. If U.S. manufacturers cannot produce a cost-effective small car, then the domestic industry will have to follow GM's strategy. "From a business standpoint, there is absolutely no reason for anyone to build a small or compact car in the United States if he can buy it somewhere else for $2000 cheaper."[30] However, in our present political environment, it is more profitable for these manufacturers to invest in special-interest lobbying, than to seek solutions to production problems.

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[25] MVMA, p. 67.
[26] "Import Quotas," p. 11.
[27] "Can Detroit . . . ?" p. 23.
[28] Edward Miller, "U.S. Car Makers Post Another Good Year," Washington Post, January 5, 1985, pp. F1-F8, and Warren Brown, "Chrysler Posts $2.4 Billion Profit in '84," Washington Post, February 15, 1985, p. F1.
[29] "Import Quotas," p. 16.
[30] Warren Brown, "GM Making Last Stab at Small Cars," Washington Post, January 13, 1985, p. E3.

WHAT NOW?

With the help of the VRA, the American automobile companies had banner years in 1983 and 1984. It would be difficult to claim that the patient is still sick. One important reason, though, for the industry's recovery is the renewed demand for mid- and large-size luxury cars, spurred by falling gasoline prices. America, of course, holds an advantage in the production of these cars.[31]

But regulations imposed on the domestic industry make it difficult for American firms to satisfy this demand. The Corporate Average Fuel Economy (CAFE) standard is one such impediment. CAFE requires that the firms' cars average 27.5 miles per gallon in 1985. A model line heavy with big cars could have trouble qualifying.

And because the American companies' own imports do not count toward the CAFE average, this regulation will diminish Detroit's ability to enter business agreements with Japanese producers when the import restrictions end. For example, General Motors has negotiated import plans with Suzuki Motor Co. Ltd. and Isuzu Motors Ltd., and has embarked on a joint venture with Toyota Motor Corp. to produce 250,000 subcompacts a year in Fremont, California. Since GM's imports would not be included in its CAFE average, it could be left with a line of large cars that are not up to standards. Chrysler and Ford will no doubt see to it that GM, which is in the best position to live without import quotas, meets these regulations.[32] This is why GM is giving small-car production one last chance with the introduction of its Saturn Corp. However, GM Chairman Smith has reminded everyone that if Saturn does not meet expectations, "You don't have to be a full-line manufacturer in order to be a full-line provider." [33]

The government must get off the auto industry's back by easing or removing CAFE and other regulations and standards that weaken the industry. Consumers can decide for themselves what kind and quality of cars they want. The objectionable regulations include the antitrust laws. Removing or modifying them would allow the industry and consumers to benefit from horizontal and vertical cooperation.

Further, the U.S. government and the domestic auto industry must stop relying on consumers to subsidize the industry. We must end the political domination by special interests, which leads to measures, such as the VRA, that harm the vast public for the short-run benefit of a chosen few.

In general, a movement towards free trade must occur if the United States wants to remain competitive internationally.[34] It is time to end the restrictions and allow the consumer to benefit. As Adam Smith argued so eloquently:

> It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy. The taylor does not attempt to make his own shoes, but buys them of the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a taylor. The farmer attempts to make neither the one nor the other, but employs those different artificers. . . . What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage. The general industry of the country . . . will not thereby be diminished, no more than that of the above-mentioned artificers; but only left to find out the way in which it can be employed to the greatest advantage.

STATEMENT OF DOREEN L. BROWN, PRESIDENT, CONSUMERS FOR WORLD TRADE

SUMMARY

1. Consumers for World Trade (CWT) strongly opposes the continuation of the "Voluntary Restraint Arrangement" (VRA) on Japanese automobile exports to the United States. These quotas were misguided at their inception and have resulted in an increase in automobile prices nearly double the rate of inflation.

2. In light of the recovery of the automotive market and the record profits reported by the Detroit manufacturers, their continuation, beyond March 31, cannot be justified.

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[31] MVMA, p. 38.
[32] Lee Iacocca . . ."
[33] "GM Making . . . ," pp. E1-E3.
[34] Steve Hanke, "U.S. Japanese Trade: Myths and Realities," Cato Journal, vol. 3, No. 3 (Winter 1983/1984), pp. 757-769.

3. For the consumer, however, the industry's recovery has not been cheap. The average price of a new car sold in the U.S. rose to $11,254 in the third quarter of 1984, according to the Department of Commerce, up from $7,591 in 1980, an increase of 48%, nearly double the rate of inflation. According to the Brookings Institution, some $4.3 billion of that increase can be attributed to the VRA. Car buyers have had to pay an average of $400 more for an American car and from $1,000 up for a Japanese import.

4. In addition to increasing the price of both domestic and imported autos, the VRA predictably created an artificial scarcity on the market of the smaller economy car. It was this shift in consumer demand which caught the domestic industry unprepared in the early 1980's. The energy crisis which prompted this shift in demand may no longer be a factor, but there will always be a massive number of Americans, particularly in the lower and fixed-income category, in need of an affordable automobile.

5. As for employment, because the quotas meant that all auto prices went up, fewer cars were made and fewer American jobs created than would have been true otherwise. Brookings estimates that as of 1983 a mixmum of 26,200 auto industry jobs could be credited to the restrictions on imports from Japan. Each job "saved" by the quotas that year was priced at some $160,000. There must be a less expensive way to create jobs.

6. CWT believes that it is high time to discontinue these quotas which resulted in an unjustifiable and unlegislated levy on every American buyer of an automobile, foreign or domestic. Revenues from this wholly arbitrary tax have gone not to the Treasury, but variously to domestic producers and dealers and to the Japanese manufacturers.

7. VRA's, or any other form of quotas, are not a long-term solution to industry's problems and have a negative impact on consumers and the national economy. VRA's do not reduce a trade deficit and contribute to the strength of the dollar.

8. U.S. trade policy should concentrate on seeking the reduction of trade barriers, here and abroad, by positive means and on preventing the erosion of an open multilateral trading system. In the long run, this will benefit all national economies and the welfare of consumers in all trading nations.

STATEMENT

Consumers for World Trade (CWT) strongly opposes the continuation of the "Voluntary Restraint Arrangement" (VRA) on Japanese automobile exports to the United States. These automobile export quotas were misguided at their inception. They have resulted in an increase in automobile prices nearly double the rate of inflation. Now, in light of the recovery of the automotive market and the record profits of the Detroit manufacturers, their continuation, beyond March 31, cannot be justified.

Following a finding by the International Trade Commission that the domestic automobile industry was not being hurt by Japanese imports, Japan was persuaded in 1981 to limit its auto exports to the U.S. The argument was made, and consumers were implicitly promised, that two or three years of respite from Japanese competition would surely give Detroit the breathing space for recovery.

The three years have stretched into four, with no noticeable apologies to or from anyone. As these things go, of course, that amount of slippage is modest. Steel has been sheltered most of the time since 1968 and has just received a new, unprecedently broad grant of official protection. Textiles are into a fourth decade of import restrictions, once advertised as a five-year recovery program.

In any case and by any relevant standard, the auto industry has recovered. It is coming off two excellent years. Sales were up 15 percent in 1983 and 13 percent last year. Profits have been at record levels, along with executive bonuses. Chrysler this month reported profits of $2.4 billion for 1984, which is more than that company earned in its entire previous half century of existence. Ford announced 1984 earnings of $2.9 billion and General Motors reported record earnings of $4.52 billion. Detroit as a whole expects total 1984 profits of between $10 and $11 billion.

For the consumer, however, the industry's recovery had not been cheap. The average price of a new car sold in the U.S. rose to $11,254 in the third quarter of 1984, according to the Department of Commerce, up from $7,591 in 1980, an increase of 48%, nearly double the rate of inflation (27%). According to a study by the Brookings Institution, a major part of that increase, some $4.3 billion, can be attributed to the Japanese car quotas that reduced competition for Detroit. With less competition, U.S. car makers were able to raise prices and the Japanese car manufacturers, in order to maximize profits and compensate for a smaller volume of sales, shipped a

more expensive mix of cars to the American market. As a result, car buyers had to pay an average of $400 more for an American car and from $1,000 upward more for a Japanese import—sometimes far upwards to judge from shoppers' anecdotes. Faced with this "double whammy," American consumers are giving serious consideration to postponing the purchase of a new car, the second major purchase after a home for the average American family.

A recently released report by the International Trade Commission (ITC) estimates even higher increases in prices: $659 more for American cars in 1984 and $1,300 more for Japanese-made cars.

In addition to increasing the price of both domestic and imported autos, the VRA, as do all restraints, predictably created an artificial scarcity on the market of the smaller, economy car. It was this shift in consumer demand which caught the domestic industry unprepared in the early 1980's. Until 1979, these small cars (compacts and subcompacts) represented less than 25% of new car sales. After the 1979 Iranian revolution and the second oil shock, subcompacts rose to 40% of sales and the small car share of the U.S. market rose from 49% to 63%. The energy crisis which prompted this change in consumer demand may no longer be a factor, but there will always be a massive number of Americans, particularly in the lower and fixed-income category, in need of an affordable automobile.

As for employment, the gain in jobs from import protection has been remarkably meager—and remarkably dear. Because the quotas meant that all auto prices went up, fewer cars were made and fewer American jobs created than would have been true otherwise. The Brookings estimate is that as of 1983 a maximum of 26,200 auto industry jobs could be credited to the restrictions on imports from Japan. With consumers paying $4.3 billion more for the cars they did buy, each job "saved" by the quotas that year was priced at some $160,000. There must be a less expensive way to create jobs.

Consumers for World Trade believes that it is high time to discontinue these quotas which resulted in an unjustifiable and unlegislated levy on every American buyer of an automobile, foreign or domestic. Revenues from this wholly arbitrary tax have gone not to the Treasury but variously to domestic producers and dealers and, yes, to the Japanese manufacturers who found themselves able to raise prices in an artificially managed market.

This case demonstrates clearly that "voluntary restraints" or any other form of quotas are not a long-term solution to the domestic industry's problems and have a negative impact on consumers and on the national economy. It should be kept in mind that VRA's do not reduce a trade deficit; they reduce only the volume of sales. VRA's also contribute to the strength of the dollar, the very situation in large part responsible for the problems of industry.

These temporary restrictions have been in existence for too long. Even Senator Danforth (R-MO), referring to an unsuccessful auto quota bill which he introduced in 1981, has stated: "It was not my intention to put the industry on permanent life support mechanism, but to provide sufficient first aid to let them be competitive."

U.S. trade policy should concentrate on seeking the reduction of trade barriers, here and abroad, by positive means and on preventing the erosion of an open multilateral trading system. In the long run, this will benefit all national economies and the welfare of consumers in all trading nations.

STATEMENT OF HON. JOHN GLENN, A U.S. SENATOR FROM THE STATE OF OHIO

Mr. Chairman, I want to thank you for calling attention to the very serious threat that the President's decision of lift restraints on Japanese auto imports poses for the American auto industry, its workers and communities.

For several years now, we in Congress and Presidents in both Democratic and Republican administrations have been struggling unsuccessfully to convince the Japanese to open their markets to American goods and services. It is now clear that conventional approaches to this problem are not taken seriously by the Japanese government and that more forceful action is required.

Our trade imbalance with Japan continues to rise. This trend heightens economic tensions between our two nations and deepens feelings of bitterness among our citizens. I can tell you that when I travel around the state of Ohio, businessmen and workers are no longer expressing frustration with Japan's trade policies, they are voicing anger. They feel victimized by the targeting of U.S. markets and by barriers to entry into Japan's market. Moreover, they are deeply disappointed with those of us in Washington who complain about our trade problems with Japan but fail to do anything about them.

And make no mistake about it, our trade problems with Japan are not confined to any one sector or our economy nor are they the result of failure to maintain our comparative advantage. In telecommunications, for example, American manufacturers sold only $110 million worth of equipment in Japan last year, while their exports of telecommunications equipment to the United States totaled $1.5 billion. The Japanese refuse to buy American communications satellites so that they can protect their own "infant industry" that they will later unleash on the the world market. Japanese bureaucrats create controls on computer communications systems that blunt the competitive edge that American manufacturers enjoy. Japanese trade negotiators drag their feet on lowering their trade barriers to such diverse industries as electronics, lumber, pharmaceuticals and medical equipment. In all of these areas—where we hold a comparative advantage—the Japanese continue to act as though free trade is a one way street.

The results of these actions have been devastating for our balance of trade. Between 1980 and 1983, U.S. exports to Japan rose from $8.1 billion to $9.7 billion, while imports from Japan increased from $31.7 billion to $42.3 billion. In 1984, the trade imbalance between Japan and the U.S. reached an all-time high of $37 billion. More than half of this bilateral deficit is in one product category: automotive trade.

Even with import restraints, America remains the most open auto market in the world. And even with a voluntary restraint agreement, Japanese import sales have continued to grow. I see no reason why we should lift these restraints—especially when it is clear that we will not get any liberalization of Japanese trade policy in return. What we will get, if we end voluntary restraints, is a larger trade deficit and a crippled auto industry.

Notwithstanding the need for reciprocity in trade, some argue that the auto industry's recent profits justify the termination of voluntary restraints. Others, including the Reagan Administration, express an attitude of benign neglect toward them. These views neglect the original purpose of these restraints, overlook the considerable efforts made by the auto industry and its workers to become competitive, and ignore the dangers that lifting restraints would pose to large segments of our economy.

The original purpose of voluntary restraints was to allow U.S. auto producers time to reduce the substantial cost advantage of Japanese manufacturers in small car production and to recover their financial strength to meet future investment needs. Neither of these goals has been accomplished. Although domestic manufacturers have made dramatic improvements in their productivity, this progress has been offset by adverse exchange rate movements. While U.S. auto producers have enjoyed a year of strong sales and profit recovery, the industry's financial recovery is not yet complete. Continued profitability over the next few years is necessary to restore their financial strength to historic levels and enable them to fund future investments.

To become competitive, U.S. auto producers have closed inefficient plants, reduced work forces by more than 25 percent, negotiated concessions in labor costs with the United Auto Workers, reduced inventories, obtained price and credit concessions from suppliers and mounted the most ambitious investment program in history. From 1979 to 1983, domestic auto producers invested over $51 billion to build more fuel efficient and higher quality cars and trucks. To meet the challenge of foreign competition, they must invest at least $50 billion more over the next five years. They will not be able to finance these investments if we lift voluntary restraints and allow Japanese auto producers to seize the small car market from them.

The long term success of the American auto industry depends on its short term success in the small car market. U.S. auto producers face critical decisions to either modernize their small car production in the U.S. or to move design and production overseas. If import restraints are lifted, the combination of Japanese excess production capacity, manufacturing cost advantage and adverse exchange rates would result in such large market share losses for American companies that small car domestic production would no longer be economically feasible.

With subcompacts alone accounting for more than 40 percent of U.S. car sales, migration of U.S. small car production to offshore locations would diminish an industrial market critical to the development of new technologies such as computer-aided design, industrial robots and laser applications. It would seriously weaken supplier industries in such areas as electronics, plastics and high strength metals. It would cast hundreds of thousands of workers out of jobs and bring economic ruin to states and communities in our industrial heartland.

Our competitive position in the international economy has deteriorated because we have failed to develop policies responsive to the changing context of international trade. Whereas private, multinational firms seeking the most efficient production

and distribution of goods and services once dominated world markets, economic nationalism now prevails. In the critical areas of oil, steel and autos, government owned or directed, vertically integrated corporations shape the flow of trade. They do so as instruments of national governments and their actions are directed by political, rather than economic considerations. Although I do not advocate adoption of such policies here in the United States, neither do I believe we can shape a coherent, effective foreign economic policy without responding to them.

Extension of voluntary auto import restraints is a step in that direction. It tells our trading partners that our markets will not be fair game until the game is fair. Just as our Federal Government has a commitment to ensure that competition among firms in our domestic market is fair, so does it have a responsibility to ensure that American firms are not unfairly disadvantaged in world markets as a result of their commitment to free enterprise. Just as we can do no longer afford to be the world's policeman, neither can we afford to be its only willing customer for goods and services.

The successful modernization of our basic industries, the employment of skilled American workers and the full expression of our service sector's creativity can not await the cessation of unfair trade practices and the realization of fair and equal investment opportunities. In short, we can no longer afford to pursue the ideal of free trade unless our trading partners are willing to reciprocate.

STATEMENT OF OWEN BIEBER, PRESIDENT, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, UAW

Mr. Chairman, the President's decision last Friday against asking Japan to extend the Voluntary Restraint Agreement (VRA) on automobile exports is a harsh message indeed for hundreds of thousands of working men and women and their families who are dependent upon our domestic auto and related basic industries.

It is bad news too for communities in many parts of our country where economic health also depends upon those industries. And it is bad news for our economy which already suffers from continuing high unemployment and an unbelievably large, escalating trade deficit because of the strength of the dollar and our refusal to call the shots for our own trade policy.

To me, Mr. Chairman, it is particularly distressing when the leader of our own government refuses to stand up for the interests of those workers, their communities, and, in our judgment, for the national interest. Once again, we are about to permit the trade policies of others to dictate what our policy shall be.

The stakes in the decision against pressing for extension of the restraints are exceedingly high—and it is important that Members of Congress are fully aware of what the consequences may be.

Estimates of additional Japanese exports range from 750,000 vehicles to more than one million cars on top of the roughly 2 million already being shipped into this country. Those kinds of numbers are frightening, because they translate into the loss of literally hundreds of thousands of jobs for American workers. The needless human suffering and economic dislocation in communities where basic industry is central to economic health will be far-reaching and deep. I cannot for the life of me understand why the President of the United States would refuse to involve himself where the economic well being of so many Americans is to obviously and fundamentally at stake.

In announcing he would not press for continuation of restraints, President Reagan expressed his hope for "reciprocal treatments" by Japan in the current open market negotiations. Mr. Reagan may once have been a union president, but if this is his idea of tough bargaining, it sure wouldn't win him a seat on any UAW negotiating team. In fact, I'd like to have him on the other side of the table.

What he's done is to give away billions of dollars worth of access to our market and he hasn't even gotten a promise from Japan that they will give us one nickel of additional access to their market. He has jeopardized hundreds of thousands of American jobs and has gotten only his "hope" that Japan will act to lower its barriers to our exports. Those exports in fact have declined in real terms during President Reagan's term in office.

What working people needed last Friday was a helping hand from their President. What they received, in our opinion, was the back of the hand.

When your hearings on this issue began last week, Mr. Chairman, we still had hopes that the President might reject the unwise recommendation of his cabinet council on commerce and trade and instead urge the Japanese to continue the VRA. That would have been the responsible course for him to have followed.

I have frequently found myself in disagreement with your views on international trade, Mr. Chairman, just as I know you have disagreed with ours. But this is one time I can honestly say I wish your prediction of last Thursday would turn out to be correct. I am told that you predicted Japan would continue to restrain its auto exports—if not as a result of Presidential urging, then on its own volition. I hope your prediction materializes for the sake of the workers I represent, their families, their communities and our Nation.

Members of this subcommittee are aware of the plans of General Motors to import large numbers of fully-assembled vehicles from Japan and to sell them through the GM dealer network. Those small cars would have 100 percent foreign "content" and would replace cars with more than 90 percent American content. General Motors' plans call for importing at least 200,000 small cars from Suzuki and Isuzu. That is why it has campaigned for lifting the Voluntary Restraint Agreement. So long as the VRA has remained in effect, GM has been unable to import the number of vehicles it wants to bring into this country.

With the Japanese decision still not made, I was distrubed to hear Chrysler's announcement last week that it was placing an order for 200,000 additional imported cars from its partner, Mitsubishi. That three-fold increase planned by Chrysler on top of the six-fold increase planned by GM cannot encourage restraint by Toyota, Nissan, Honda, Mazda, or Subaru.

In the interests of our Nation and their own workers, I today call on GM and Chrysler to set an example of restraint and responsibility. If they instead push the floodgates wider, they will be acting contrary to the national interest.

Mr. Chairman, we believe the U.S.-based companies have a special obligation to keep jobs and production here in the market that they have enjoyed and in which they have prospered. They owe that to the workers and to the people of America. We will do what we can to see to it that they meet their responsibilities. But we cannot do it alone.

Let me emphasize one point now, Mr. Chairman. Lifting the VRA will not adversely effect the profits of the auto companies; the executive bonuses may be as outrageous—and profits may soar even higher as they import more small cars.

The American workers and their families and neighbors are the ones who will be hurt if the VRA expires. They are the ones whose communities will be devastated. They are the ones who will lose their jobs. They are the ones who will suffer as the companies profits remain at record levels.

Last year, our country suffered a staggering trade deficit of $123 billion. With Japan alone, we had a deficit of $37 billion. That's larger than our deficit was with the entire world in 1980.

In the auto industry—including cars, trucks, and parts—we ran a $34 billion deficit with the rest of the world. The only industry with a larger deficit was oil.

Despite the restraints on cars from Japan, our auto deficit has swollen to $20 billion. That's more than half our deficit and it represents the loss of half a million American jobs.

The President's failure to push for an extension of restraints may mean our trade deficit with Japan will grow by an additional $5 to $7 billion, and the loss of 200,000 jobs in the short run.

The administration knows full well the devastation that is sure to follow with the lifting of restraints. Ambassador Brock estimates the U.S. could expect 750,000 additional imports within 12 months if the VRA is lifted. Such a flood of imports would create massive dislocations in the auto industry here, just at a time when stability is needed to continue improving U.S. competitiveness. That surge would cost jobs in auto and related industries such as steel, electronics, rubber, glass, mining, robotics and high technology.

Ambassador Brock brushed off the loss of jobs with the argument that those workers can find other jobs in an expanding economy. That argument is seriously flawed. For one thing, many who will lose their jobs in parts production and assembly for small cars are older workers who can neither find new jobs nor pick up and move easily. In addition, the kind of import surge he predicts could hinder the creation of new replacement jobs. Such a setback to this key sector of our economy could help trigger a recession. We already see our Nation's unemployment rate rising and other early indicators of an economic slowdown.

The Commerce Department analysis used in interagency discussions on ending the VRA also paints a bleak picture. The report states flatly that the Japanese industry can produce three million cars for export here without any overtime. That's a million more cars than they ship today. And with modest overtime, Japan could export far more cars.

Japanese auto production has been falling far short of its capacity because it has had nowhere else to go before now. In the first place, the car market in Japan is flat. Secondly, their car exports face tight restraints almost everywhere else in the world. For example, the European Community limits Japanese imports to 7 percent of that ten country market. With no limitations on exports into the U.S., they could utilize that unused capacity to produce more and more for this market.

The Commerce study also projects that expiration of restraints would result in about 800,000 fewer small cars being manufactured domestically in 1986 and 1,100,000 fewer in 1987. Those figures confirm our fear that America is on the verge of having our domestic automakers supply this country with small cars built abroad rather than here.

The VRA has been successful in helping to bring initial investments by Japanese automakers here where they enjoy such a huge market. We supported keeping it in place for an additional period of several years in order to stimulate further decisions, such as Mazda made recently to open factories here and create jobs in American communities.

We do not favor a permanent limit on Japanese car imports, but restraints should be kept in place until the yen and dollar return to a fair balance. The dollar has appreciated more than 25 percent against the yen since January, 1981. That imbalance puts American producers at a $1,500 cost disadvantage on a $6,000 car. That overshadows much of the effort made to improve U.S. competitiveness.

The undervaluation of the yen is shown by Japan's soaring trade surplus with the world now at $44 billion. Compared with the size of its economy, that surplus is larger than the U. S. trade deficit. Keeping restraints as long as the exchange rates are misaligned would allow the continued strengthening of the U.S. auto industry.

In the last four years, productivity has grown by a remarkable 35 percent. Auto plants today have become the envy of many so-called "high tech" industries which still rely on less modern production equipment.

The quality of American cars has improved. The companies have learned that our members have many good ideas for making cars better. In addition, they are designing cars [illegible] plants with more attention to consistent high quality. Finally, they have sub[illegible]lly shifted their product line to offer more fuel efficient cars and vans than w[illegible]e available four years ago.

During the period of the restraints, the UAW has bargained responsibly—both for our members and for the country. Most independent analysts of the industry viewed last fall's contracts with General Motors and Ford as non-inflationary. In bargaining two years before that, our members made significant sacrifices in recognition of the difficulties the companies were then experiencing. We realize that it is impossible to solve all our problems at the bargaining table. Some of them, such as trade and currency imbalances, require governmental actions.

Many consumers are rightfully concerned about prices. So are we. The American consumer pays more for the average car today than four years ago, but in spite of what many people believe, that has little to do with the VRA. People are paying more for cars mainly because they are buying more automotive accessories and more large cars.

If the VRA was having a major impact on prices, it would be reflected in small car prices. In fact, as all three U.S. car companies testified last week, U.S. small car prices have been rising roughly two percent a year—well below the increase in the consumer price index.

Keeping the restraints may well bring lower prices on small cars in coming years. Even if Japan keeps restraints at their current level, there will be growing competition in our small car market. Japanese companies plan to assemble a million cars here in addition to the two million they now export.

We often hear a totally illogical argument that the Japanese companies really don't want to ship any more cars to us. They can make higher profits, so the argument goes, by restricting their sales. But if they can hike prices on sales of 2 million cars now, why not join with the U.S. companies and supply the entire 4 to 5 million unit small car market with imports, and then raise prices?

With the lifting of restraints, car imports from Japan could rise to three million in short order. We doubt that the additional million imports will have much effect on small car prices. But certainly we'll pay a steep price in terms of hundreds of thousands of lost jobs in auto, supplier and related industries. And when these workers lose their jobs, sooner or later people in the local grocery store are out of work and the insurance salesmen can't make a living.

In my opinion, that seems very likely to happen. American consumers as well as American workers will be much better off if we retain our production base for small cars.

The U.S. has successfully built up substantial capacity to manufacture small, fuel-efficient cars since the first oil shock and the 1975 fuel economy legislation. Much of that capacity, including parts facilities, is threatened with extinction with an end to the VRA at this time.

Before this subcommittee and elsewhere, GM has been suggesting that there should be a relaxation of the corporate average fuel economy—so-called CAFE—standards on cars produced here. GM has already fallen below those standards which were set 10 years ago as part of the Energy Policy and Conservation Act.

GM will soon phase out its production of two models that get high miles per gallon, the ten-year-old Chevette and the six-year-old X cars. Although both models have had longer than average life spans, GM has no new models to replace them. Instead, GM plans to import at least 200,000 cars from Japan and up to 100,000 cars from Korea. GM has also campaigned for an end to the VRA which, it acknowledged to you last week, will mean a cutback in its remaining production of smaller cars. In other words, GM is flouting the CAFE standards and now wants relief. GM acts like a guy who got caught going 80 miles an hour and then lobbies to change the speed limit.

The imbalance in auto trade is only the largest of many trade problems we have with Japan. On the export side, there has been no real progress over many years of talks. With great fanfare, Japan has announced five import liberalization packages in recent years.

But when you strip away all the window-dressing, you find that our real exports to Japan are lower today than they were four years ago. Unfortunately, it's not the same story when it comes to trade in the other direction. Japan's shipments to us have doubled since 1980.

The President's unwise decision on the VRA offers a tragic and classic case study of why the U.S. never seems to come out ahead in trade negotiations.

In autos, as in most products, the U.S. has the largest, most attractive market in the world. We have tremendous leverage if we ever learned to use it the way Japan does. My only regret is that the administration does not negotiate as effectively as the Japanese Government does.

America seems to have more than its share of those who call themselves free traders. But how can America practice free trade when no other industrial country, least of all Japan, practices free trade? It seems to us, Mr. Chairman, that we have to operate in the real world, and that is not a world of free trade, as much as many might wish for it.

The free traders contend that we should never consider limiting imports because imports then might be more costly. What they ignore or forget are the social and economic costs of doing nothing. There are important interests here, and it is important to balance them.

So long as those free-traders carry the day in the counsels of our Government, we will never make serious progress in commercial access for our products and our industrial base will erode.

The current talks with Japan on autos and telecommunications shows the basic weakness of the U.S. approach. President Reagan's statement that he would not urge extension of the restraints, he concluded "in taking this action, I hope that we can look forward to reciprocal treatment by Japan."

In other words, we should make an immediate and colossal concession in the vain hope that our example will lead Japan to follow suit. For its part, Japan is threatening to close its telecommunications market in the full knowledge that an agreement to return to the status quo ante will be hailed as a victory by the U.S.

Ambassador Brock explained that his top priority in negotiations with Japan is improving access to their telecommunications market. The problem there is that Japan is changing its telephone monopoly, Nippon Telephone and Telegraph, from a public company to a private company.

We have had an agreement with the Japanese Government that NTT would give favorable treatment to U.S. exports. When you look at the numbers, however, we exported $27 million worth of telecommunications equipment to Japan last year—roughly one percent of total NTT's $3 billion purchases. Meanwhile, Japan exported $941 million worth of telecommunications equipment to us—up 100 percent from the year before.

The point is that Japan is taking the initiative—threatening to reduce our one percent access to its $3 billion telecommunications market. We are begging Japan not to reduce our access.

On the other hand, in autos the U.S. has already conceded to Japan $20 billion of its $150 billion market. The issue is whether to make an immediate concession of

another $5 to $7 billion, worth 200 times our current telecommunications exports to Japan and twice the entire Japanese telecommunications market.

Even with a more effective use of auto as a lever to open markets, any good negotiator would expect measurable performance by Japan first, rather than more promises. That means restraints should have been kept in place until Japan has actually provided greater access and we see substantial progress in exports and a substantial reduction in the bilateral trade deficit.

In recent weeks, administration officials have said that if Japan seriously wanted to cut the $37 billion imbalance, it could be cut by $10 to $12 billion. I say fine, let's stop talking about it while the deficit keeps soaring. Let's take some firm steps to bring down the deficit.

Even while considering the possibility of other legislative approaches, I should point out that we have not abandoned our long-term goal that has been embodied in the domestic auto content legislation. VAR and our pressure for content have both moved us along toward our real long run goals. We seek investment and job creation by the major foreign multi-nationals enjoying huge sales in this country. And we want to keep the U.S.-based companies in the business of producing here.

Mr. Chairman, we have appreciated the opportunity to share the views of the UAW on the VRA with you and members of the subcommittee. We believe the decision of the President is most unwise and unfortunate. We hope it does not lead to an end of Japanese restraints, but we fear that it may. If it does, we will have to look once again to the Congress for action to stem the tide and prevent further erosion of our industrial base.

TIMKEN CO.,
Canton, OH, February 22, 1985.

Hon. SAM M. GIBBONS,
Chairman, Subcommittee on Trade, Committee on Ways and Means, House of Representatives, Washington, DC.

DEAR MR. GIBBONS: The Timken Company is a component supplier of alloy steel and antifriction bearings to automotive manufacturers. We are currently in the process of constructing a greenfield site steemaking facility near Canton, Ohio. This facility represents a substantial investment by the Timken Company toward the recovery of the domestic steel industry. It is virtually impossible for us to participate in the Japanese automotive manufacturing business due to import restraints practiced by the Japanese. In contrast the Japanese have been quite successful in participating in our domestic market as is illustrated by the great imbalance in trade between the United States and Japan in the areas of alloy steel and antifriction bearings.

Department of Commerce statistics for 1984 indicate that the United States imported $290,000,000 worth of antifriction bearings from Japan while exporting only $8,200,000 worth to Japan. Exports equaled less than 3% of imports. In addition, we have estimated that another $75,000,000 of Japanese antifriction bearings entered the United States as components to finished Japanese automobiles.

American Iron and Steel Institute figures for 1984 show that the United States imported 262,558 tons of alloy steel from Japan while exporting only 2,292 tons to Japan. Exports equaled less than 1% of imports. In addition, we have estimated that another 95,000 tons of alloy steel incorporated in finished Japanese automobiles were imported. Available import figures do not account for the large additional numbers of bearings and amounts of steel which are awaiting clearance into the United States.

Should the current restraint level be allowed to expire, we expect that the number of Japanese automobiles imported into the United States for the balance of 1985 will reach at least 2.2 million units. This will increase the amount of both antifriction bearings and alloy steel entering the United States as Japanese automobile components by more than 18% over that allowed by the current voluntary restraint level. Currently, the Japanese consume 3 million of the 7 million automobiles they manufacture annually. Of the remaining 4 million units, 1.85 are exported to the United States and 2.15 are exported to other international consumers. If automobile imports from Japan remain unrestrained in future years, we can expect the Japanese to keep a careful watch on the worldwide marketplace and divert units to this country to the degree necessary to take advantage of the profitable and fully accessible United States market. Because Japanese capacity largely exceeds domestic consumption their increased penetration into the United States market will be impossible without further capital commitments. The final result of the expiration of

the restraint level will be further loss of American jobs, further weakening of the American industrial base and reduction of federal, state and local tax revenues.

We urge your support in renewing the voluntary restraint level that is currently in effect.

Sincerely,

JOSEPH F. TOOT, Jr., *President.*

STATEMENT OF DAVID J. STEINBERG, PRESIDENT, U.S. COUNCIL FOR AN OPEN WORLD ECONOMY, INC.

(The U.S. Council for an Open World Economy is a private, non-profit organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The Council does not act on behalf of any "special interest".)

This Council opposed U.S. pressures on Japan to restrict exports of automobiles to the United States. We did so, not out of purist, ideological dedication to unrestricted international trade, but because (a) imports were not conclusively judged to be the major cause of the U.S. industry's malaise, and (b) there was no coherent U.S. auto-industry redevlopment strategy as the framework for whatever import restraints the U.S. government deemed proper and prudent. These principles underlie our opposition to continuation or resumption of such trade restrictions after expiration of the current, four-year "voluntary restraints" on March 31, 1985. There is still no adjustment or redevelopment strategy with respect to the U.S. auto industry—a strategy involving, not only government measures in pertinent areas of public policy, but also quid pro quo commitments by industry and labor. Trade restriction and other forms of government aid are subsidies, involving a cost to the public interest that should entail a price from beneficiary private intersts in the form of appropriate commitments for which they would be held fully accountable.

The strategy framework for continuation or resumption of auto import controls (to the extent that such controls are justifiable at all) should include reassessment of all statutes and regulations materially affecting the U.S. industry's ability to adjust to unrestricted imports of automobiles, and the earliest removal of any inexcusable inequities that may be found. Other forms of government assistance outside the realm of import restrictions may also be warranted. As suggested above, the auto companies and their labor force should themselves make commitments concerning steps to facilitate the adjustment effort to which a compact of government, industry and labor would be directed.

In short (paraphrasing Hamlet): To restrict or not to restrict auto imports is not the only question the Congress and the Administration should be addressing. In taking arms against a sea of troubles rather than suffer the slings and arrows of outrageous fortune, 'tis nobler in the mind and in the public interest to take coherent action aimed at solving problems, not a simplistic step that could lead to new ones. Ay, there's the rub—knowing the difference.

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